C.D. Howe Institute

# Canada's Energy Policy Debate

Observation No. 23

Wendy Dobson

Legal Deposit — 2nd Quarter, 1981
Quebec National Library
ISSN 0381-5250

Quotation with appropriate credit is permissible
C. D. Howe Institute, Montreal

Printed in Canada — May, 1981, $3.00

ERRATA

The second full paragraph on page 40 should read as follows:

"In summary, in early 1981 the risks created for the supply response to the NEP appeared to be serious primarily because of Alberta's decisions. The risks on the demand side seemed somewhat smaller. Although the conservation responses anticipated by the NEP seemed overly optimistic in the absence of larger consumer price increases, the off-oil response seemed possible to achieve."

103-00988/

# Canada's Energy Policy Debate

**Summary**

The National Energy Program (NEP) has stimulated widespread debate over the means chosen to achieve its expressed goals of security of oil supply, opportunity for greater Canadian participation in the petroleum industry, and fairness in petroleum pricing and revenue sharing. This debate has focused on the effects of the pricing and taxation measures on the producing provinces and the petroleum industry and on Canada's prospects for achieving oil self-sufficiency. Moves to Canadianize the petroleum industry through increased private and public sector ownership by Canadians have also stimulated controversy, as has the NEP strategy for achieving oil self-sufficiency.

These aspects of the debate have been somewhat overshadowed, however, by the policy impasse between Ottawa and Alberta — an impasse that arises from fundamentally different interpretations of management of resource revenues in the federal system. Alberta and the other producing provinces want wellhead prices to rise faster than does the federal government, with the benefits being distributed throughout the country by means of the resulting faster economic growth and job creation. They want what they regard as a fair share of the revenues in order to develop their economies and maintain their current prosperity when their petroleum resources are depleted. They view the NEP's pricing and taxation measures as creating barriers to the realization of their economic aspirations.

In the NEP the federal government asserted its view of its role in, and responsibility for, managing the consequences for the entire economy of increasingly valuable petroleum resources. The federal government sought revenues to carry out what it sees as its responsibility for redistributing the benefits of these resources among all Canadians. To raise the necessary revenues, it has held the wellhead producer price below the consumer price and has used the room created to impose taxes on production and consumption.

When the NEP was imposed in the absence of an agreement between the federal government and the producing provinces, Alberta expressed its opposition by cutting back petroleum production. The resulting stalemate is due to each government's failure to recognize the requirements of the other. However, this means that all Canadians must bear the cost of the stalemate because they stand to lose more from the policy impasse than they would from the NEP or even from Alberta's 1980 proposal. This is because Canadians must now rely more heavily on costly imports to meet their oil requirements and because, as long as consideration of the oil sands projects is stalled, major investment activity and employment opportunities will also be stalled.

By early 1981 the most obvious solution to the impasse seemed to be for the two governments to compromise on higher wellhead prices for conventional oil. Canadians have to pay higher prices to cover the cost of additional oil imports anyway. The prospect of paying foreign producers for added supplies at world prices because of a policy that seeks to avoid paying higher prices to domestic producers only adds to the NEP's divisive consequences. However, it is likely that resolving the impasse will require more compromise on both sides. NEP taxation measures are also perceived as an affront to the economic aspirations of the West, and although the natural gas and liquids tax will be settled in the courts, the underlying issue will have to be addressed more adequately by Ottawa. For their part the producing provinces must take greater account of Ottawa's revenue needs and of the consequences for the national economy of the growing wealth from their petroleum endowments.

# Canada's Energy Policy Debate

The debate that has emerged in the wake of the National Energy Program (NEP) leaves two major impressions on Canadians and, indeed, on the international community. The first is that the governments in Ottawa and Alberta are engaged in a game of "chicken" over the division of the spoils created by higher oil prices, with energy users and the petroleum industry caught in between. The second is that, between them, the two governments may have paralyzed crucial energy supply activity and increased Canada's vulnerability to international disruptions in oil supplies.

The debate involves more fundamental issues, however. The current policy impasse has increased Canada's vulnerability, but the stakes are higher than simply the division of the spoils. The underlying issues in the impasse are based on differing perceptions of the balance of power in the federal system. In a country richly endowed with energy resources, energy policy is a key to the future national social and economic structure. Most energy resources now in production are owned by the provinces but are unequally distributed among them. As the value of the resources, and consequently the wealth and incomes accruing to the producing provinces, has increased, questions have been raised about the necessity of mechanisms to facilitate distribution among all provinces. The federal government has one view of how these incomes should be distributed, while the resource-owning provinces have another view.

The federal government believes that it is responsible for managing the national economy, which includes managing resource allocation and distributing the income from those resources. Accepting the rapid increases in world oil prices since 1973 would have meant radical shifts in economic activity to the West and shifts in

*Author's Note* After this Observation had been written, the Alberta Court of Appeal ruled that the federal government could not tax natural gas from provincially owned wells. Although this decision is not mentioned in the text, the broad issues that prompted recourse to legal channels are discussed.

purchasing power from energy users in all parts of Canada to resource companies and their shareholders and to residents and governments of the provinces producing oil and natural gas. The federal government has chosen to hold down oil prices in Canada in order to attenuate these effects.

The producing provinces have taken a different view — one expressed by Alberta, the major petroleum-producing province. They want a greater say in pricing and taxation decisions in order to ensure that they receive what they regard as a fair share of the revenues to diversify their economies against the day when the resources are depleted. The producing provinces view the prospect of a shift in economic activity to the West as having less serious redistributional consequences than does Ottawa because of the spin-offs that will be created in the other regions. They believe that petroleum prices should be closer to commodity value in international markets and that Ottawa should satisfy its revenue requirements through income and excise taxes. Because of the differences in these views, the pricing of oil and gas has become a central issue in the debate.

Another issue being debated concerns strategies to achieve oil self-sufficiency. Canada's net oil imports have been increasing since 1976. The federal government has decided to place greater emphasis on reducing oil demand than in the past and seems to be less concerned than in the past with expanding domestic supplies. The impact that has been forecast is viewed with skepticism by a number of observers. The implications of the federal decisions to increase Canadian ownership and control and to increase the public sector's role in the petroleum industry have also provoked widespread debate.

The federal government imposed the NEP in the absence of an agreement with Alberta and in doing so has imposed pricing and taxation measures that Alberta finds unacceptable. Alberta's proposals, made in July, 1980, were judged unacceptable by the federal government because they took inadequate account of the latter's need for increased, and more certain, revenue sources. Alberta has defended its position by exercising its only weapon — its control of production. The resulting impasse represents each government's failure to recognize the requirements of the other. Canadians stand to lose more as a result of the production cutbacks than they would under either the NEP or the Alberta proposal, and the persistence of both governments in maintaining their positions has begun to resemble a game of "chicken." It is therefore in the interests of all

Canadians that a solution be found. Energy policy should be one of the keys to Canada's social and economic future, not a stumbling block. Our purpose in this Observation is to examine the origins of the current impasse, the problems the NEP set out to solve, and the reactions it has stimulated.

In the first section of the study we describe the NEP — its objectives and the means by which they are to be achieved. In the second section we examine the goals of, and constraints on, energy policy in Canada and suggest that Canadians have two proposals to consider — the NEP and Alberta's proposal, made public in July, 1980. In the third section we assess the means chosen to achieve the NEP's goals and the issues that the NEP has raised, including the differences between Alberta and Ottawa that lie at the heart of the current impasse and the risks that the policy creates for security of supply objectives. Finally, we examine the current impasse and assess the debate about the options for breaking that impasse.

## The National Energy Program

The NEP consists of a complex package of measures aimed at achieving three main goals:

- "security of oil supply" and eventual independence from imported oil
- "opportunity" for greater participation by Canadians, particularly in the petroleum industry
- "fairness" in petroleum pricing and revenue sharing.[1]

The strategy proposed for achieving security of oil supply stresses conservation and substitution of natural gas (which is currently in surplus supply) for oil in non-transportation uses. Consumer prices for natural gas are to increase more slowly than those for oil, and additional incentives are to be employed to induce consumers to switch. Regulations and incentives are also to be used to promote conservation, and measures are to be taken to encourage oil supply from oil sands and enhanced recovery from existing wells and from heavy-oil upgrading.

Opportunity for greater Canadian participation in the oil industry is to be achieved by restructuring the incentives to the petroleum industry to favor Canadian-owned firms, by encouraging the takeover of foreign firms by private Canadian firms, and by participating

[1] Department of Energy, Mines and Resources (EMR), *The National Energy Program, 1980* (Ottawa, 1980), p. 2. This publication will henceforth be cited as the *NEP*.

in takeovers through Petro-Canada. Acquisitions by Petro-Canada are to be paid for through foreign borrowing and through the taxing of energy users, the proceeds of which will be used to establish a Canadian Ownership Account. The existing incentive system, consisting of depletion allowances for petroleum exploration, is to be phased out and replaced by the Petroleum Incentives Program (PIP), a system of grants whose sizes depend on the location of exploration — the largest grants are available on the Canada Lands — and on the extent of Canadian ownership, determined through a complex system called the Canadian Ownership Rating (COR).[2] The administration of the Canada Lands will be changed to reserve an interest by Petro-Canada in all exploration activity, with the option of converting this interest to a working interest (one in which costs and risks are assumed) at any time prior to authorization of production. Several other measures that will contribute to the Canadianization goal are listed in the second column of Table 1.

The fairness objective is to be achieved by establishing a blended price for oil consumed in Canada. This blended price is composed of the wellhead price plus the Petroleum Compensation Charge (PCC), which is levied at the refinery gate to cover the cost of subsidies to producers of oil from oil sands (the "Syncrude levy") and to refiners who acquire the more costly imported oil. In this way the blended price becomes an average cost of domestic and imported oil. A commitment is made to keep this blended price below 85 percent of the world price. New federal taxes are also imposed to raise revenues to finance a number of energy initiatives and economic development programs to be undertaken by Ottawa. These taxes include the Petroleum and Gas Revenues Tax (PGRT) — an 8 percent tax on net production revenues from oil and gas — and a tax on natural gas and liquids.

All these measures — as well as several others — are shown in Table 1, which compares the contents of the NEP with the proposals made by Alberta in July, 1980.

### The Context of the NEP

The NEP — and the debate that it has provoked — is complex because the management of a nation's energy resources presents

[2] Canada Lands refers to the areas of Canadian territory that, under the BNA Act, fall under federal jurisdiction. These areas include the offshore, the Yukon and Northwest Territories, and a number of scattered areas in the provinces. Newfoundland and Nova Scotia argue that offshore areas lie within provincial jurisdiction; a 1967 ruling by the Supreme Court of Canada established that lands off the west coast are within federal jurisdiction.

complex economic and social challenges arising from the fundamental role of energy in so many aspects of human activity. From the economist's perspective, energy policy — like any other policy — should be formulated to enhance welfare by contributing to rising living standards, reasonable price stability, trade objectives, employment, and equitable distribution of income — not only at one point in time, but among generations. In an economy dependent on fossil fuels for more than half its energy requirements and increasingly dependent on imported oil in an unstable international environment, the achievement of a supply-demand balance in oil is a goal of fundamental importance to overall objectives. Because of Canada's potential — and vulnerability — in oil production, much energy policy discussion has concentrated on this energy source.

Conflicts among objectives can arise when considering alternative energy policies. For example, raising oil prices to world levels will promote the efficient allocation of oil supplies but can increase inflation and unemployment while the price increases pass through the system. Other constraints that must be considered in the formulation of energy policy in Canada may necessitate trade-offs and compromise in the means chosen to achieve policy goals. For example, because fossil fuel reserves are finite (once these resources are taken out of the ground, less remains for use in future), considerations of intergenerational equity constrain the rate at which these supplies can be developed.

Increasing Canadian participation in the oil and gas industry is another energy policy goal that constrains overall choice. Canadians have allowed foreign firms to acquire a high profile in oil and gas exploration, development, and production. As the value of these resources has increased, the ownership structure of the industry and the distribution of incomes between foreigners and Canadians have attained increasing importance.

An overriding constraint on the formulation of energy policy, however, is Canada's constitutional framework. Natural resources belong to the provinces according to the BNA Act, and because these resources are unequally distributed among provinces, so also are the increasing revenues from producing them. Leaving this situation undisturbed would mean a shift of wealth, economic activity, and population to the resource-rich provinces, with serious transitional and long-term consequences. To attenuate this process, at least three mechanisms have been applied to redistribute energy revenues more equally. One is the equalization system — a general system designed to ensure that all provinces are able to provide

TABLE 1

**The Two Proposals**

**Alberta's Proposals**[a]

*Producer Prices*

Principle for pricing conventional crude oil:[c]
Price should be "fair," reflecting a fair return for a depleting resource, the commodity value of which is established in international markets.

Speed and level of price change:
Move to 75 percent of the North American price by January 1, 1984.

Schedule for wellhead increases:

| | |
|---|---|
| Rest of 1980[d] | $2.00 |
| 1981 | 5.00 |
| 1982 | 5.00 |
| 1983 | 5.50 (est.) |
| 1984 | 5.00+ (est.) |
| post-1984 | n.a. |

**Federal Proposals**[b]

*Producer Prices*

Principle for pricing conventional crude oil:[c]
Price should reflect supply conditions in Canada.

Speed and level of price change:
Move by the end of the decade to the price proposed for non-conventional oil.

Schedule for wellhead increases:

| | |
|---|---|
| Rest of 1980[d] | $2.00 |
| 1981 | 2.00 |
| 1982 | 2.00 |
| 1983 | 5.50 |
| 1984 | 5.50 |
| post-1984 | 7.00 |

Oil sands price:
$38 plus annual CPI.

Tertiary:
$30 plus annual CPI.

Frontier:
Not specified.

*Consumer Prices*

A blended price composed of the wellhead price plus the Petroleum Compensation Charge (PCC) levied on the consumer to cover the cost of the Syncrude levy and oil imports.

*Natural Gas Pricing*

Keep natural gas prices at 85 percent of the energy equivalent price for oil in eastern Canada, with 65 percent incentive pricing for new gas sales east of Alberta for five years.

*Taxation and Royalties*

- Lower royalties on Alsands and Cold Lake projects than on the Syncrude project.
- No increases in royalties on conventional oil and natural gas.
- Lower royalties for new conventional oil discoveries, for enhanced recovery, and for low-productivity wells.
- Federal wellhead tax and tax on natural gas exports opposed.

*Incentives*

Continuation of exploratory drilling and geophysical incentive program.

*Canadianization*

Alberta would commit sufficient debt and equity investment to ensure that Canadian ownership in the next three oil sands plants reaches 50 percent.

*Natural Gas Pricing*

Consumer prices are to increase more slowly than oil prices, with no increase in the wellhead price in 1981 to allow for phasing in of the natural gas and liquids tax. Montreal, Quebec, and Halifax city gate prices are to be subsidized to equate them to the Toronto city gate price.

*Taxation and Royalties*

- Natural gas and gas liquids tax.
- 8 percent tax on net production revenues from oil and gas.

*Incentives*

Depletion allowances for oil and gas exploration and development phased out and replaced by the Petroleum Incentives Program (PIP), a system of grants the sizes of which depend on the site of exploration and on the extent of demonstrated Canadian ownership.

*Administration of Canada Lands*

Reservation of a 25 percent interest for Petro-Canada in all activity up to authorization of production.

*Canadianization*

- Structuring PIP to provide incentives for expansion of the share of Canadian firms in the private sector of the oil and gas industry.
- Reservation of Petro-Canada's 25 percent interest in activity in the Canada Lands.

- Requirement of 50 percent Canadian ownership in oil sands plants and at the production stage in Canada Lands.
- NEB to take Canadian ownership into account in considering export applications.
- Creation of Natural Gas Bank to aid small Canadian firms.
- Declaration of intent to acquire foreign oil and gas firms and to establish Canadian Ownership Account to pay for the acquisitions.

*New Measures to Achieve Oil Supply-Demand Balance*

- Investment of $7 billion in three new oil sands plants.
- Promotion of gas substitution for oil.
- Financing of gas pipelines to Quebec and the Maritimes.
- Research into enhanced recovery schemes.
- Financing at the invitation of the federal government and other provinces of other energy projects such as refinery conversions and a western electric grid.

*New Measures to Achieve Oil Supply-Demand Balance*

- Incentives for exploration and development of non-conventional oil and heavy-oil upgrading.
- Substitution of other fuels for oil.
- Regulations and expenditures to promote conservation and development of renewables.
- Expenditures to promote energy adjustment in eastern Canada and in the Atlantic provinces.



*Economic Development*

Investment in improved transportation facilities in western Canada.

*Economic Development*

Western Development Fund.

n.a. = not available

[a] Presented on July 25, 1980.
[b] Proposed in the National Energy Program, October 28, 1980.
[c] Implicitly stated in the proposals.
[d] A $1.00 increase, delayed in 1979 to January, 1980, had already been imposed. The total increase in 1980 was $3.00.

Sources: Government of Alberta, "Alberta's 'Energy Package' Proposal, Including Commitments for Canadian Energy Self-Sufficiency," mimeographed, Edmonton, July 25, 1980; Department of Energy, Mines and Resources, *The National Energy Program, 1980* (Ottawa, 1980).

some comparable level of public services without resorting to unequal levels of taxation.[3] Rapidly rising energy revenues have created important problems for this system, and although the existing federal-provincial agreement is to be revised in 1982, some changes have already been legislated. The existing framework constrains energy policy because, when oil price increases are negotiated, a portion of the increase in revenues accruing to the producing provinces has to be equalized among the "have-not" provinces out of the general revenues of the federal government. When oil prices rise, the federal government must increase its expenditures for equalization payments. The question of whether the energy policy discussion should continue to take place in the context of the existing framework for equalization must therefore be posed.

The second mechanism used to equalize the distribution of rising oil values is pricing itself. Since 1973 the federal government has held the domestic price below the world price. Energy users have thus benefited at the expense of producers and the producing provinces.

A third mechanism for recycling resource revenues in Canada is also being developed by Alberta; it is lending money from the Heritage Savings Trust Fund to other provinces at a common interest rate based on the rate that the most credit-worthy province could obtain at the time of the loan.

Energy policy in Canada was first formalized in 1961 with the National Oil Policy. The intent in 1961 was to create a domestic market for oil produced in the West — which was then more costly in the East than were imports — and to promote development in the West based on the extraction of oil and gas. By the early 1970s, perceptions of increasing scarcity of energy supplies began to be articulated in policy aimed at allocating resources among competing uses. A new national oil policy was proposed in 1973; it set a goal of Canadian self-sufficiency in oil and oil products by the end of the decade. This goal was to be achieved by extending the western oil pipeline to Montreal, establishing a public sector presence in the industry, developing the Alberta oil sands, and establishing guidelines for energy conservation and interfuel substitution.[4] Although

[3]For a detailed analysis of the equalization program and of the difficulties created by increased petroleum revenues, see Thomas J. Courchene, *Refinancing the Canadian Federation: A Survey of the 1977 Fiscal Arrangements Act* (Montreal: C. D. Howe Research Institute, 1979).

[4]This policy was outlined in a speech by the Prime Minister (see the debate on the Energy Supplies Emergency Act in *House of Commons Debates*, December 6, 1973, p. 8478ff.).

prices increased at that time, the decision was also taken to insulate Canadian energy users from full world oil price increases and to subsidize oil imports.

Self-reliance in ten years was adopted in 1976 as the goal of energy policy, with the intent of reducing vulnerability to arbitrary changes in the price of imported oil and to disruptions in supply.[5] This policy was largely a developed version of the 1973 policy, although the intention to move to world oil prices was articulated.

In 1979 the Progressive Conservative government adopted a goal of self-sufficiency by 1990, to be achieved by raising domestic oil prices to 85 percent of the lower of either the Chicago blended price or the world price and by imposing an excise tax on gasoline to raise revenues.[6] An energy tax credit would have responded to equity considerations, and some tax preferences were designed to encourage Canadian participation in the industry.

During the 1970s, energy policy became increasingly entwined in the constitutional debate over resource ownership and over the division of responsibilities between the federal and provincial governments.[7] Dispute over revenue sharing increased as producer prices for oil rose. In 1974 a major federal-provincial dispute arose when Alberta increased its royalties to obtain a greater share of revenues from the oil price increases. Since these royalties were deductible from producers' federal income taxes, their effect was to reduce Ottawa's revenues. Ottawa responded by eliminating the tax deductibility of royalties, which had the effect of increasing taxation of the industry. The royalties were subsequently modified, but federal-provincial friction over oil pricing has continued. In 1980 the Alberta government prepared its own proposals for an energy policy package. As a result, by early 1981 there were really two proposals for oil and gas policy in Canada — the NEP and the July, 1980, proposal by the Alberta government.

### The Alberta Proposal

A comparison of the main elements of both Alberta's and the federal government's proposals is presented in Table 1. Each proposal is concerned about achieving oil supply-demand balance, but

[5] See EMR, *An Energy Strategy for Canada: Policies for Self-Reliance* (Ottawa, 1976).

[6] Department of Finance, *Budget Speech*, December 11, 1979 (Ottawa, 1979).

[7] For background and some of the implications, see Rowland J. Harrison, "Natural Resources and the Constitution: Some Recent Developments and Their Implications for the Future Regulation of the Resource Industries," *Alberta Law Review* 18, No. 1 (1980): 1-21.

there are differences in the pricing and taxation measures put forward. In addition, in its plans for reinvesting energy revenues in productive uses throughout the economy, each proposal reflects a different role for the respective governments in managing the impact of rising petroleum prices.

The Alberta proposal contains several elements on oil and gas pricing, royalties, and taxation that indicate some recognition of federal revenue requirements and other elements that recognize the need to recycle revenues and increase Canadian participation in new activity:

- Although the wellhead price of conventional crude oil would rise faster than proposed by Ottawa in the NEP, the level to which it would rise would be only 75 percent of the North American price — a reduction from the 85 percent level that was under negotiation with the Progressive Conservative government in 1979.
- Alberta would undertake to invest in the next three oil sands projects sufficient debt and equity to ensure that they are 50 percent Canadian-owned by 1990.
- Provincial revenue claims would be reduced on oil sands production and other forms of future production and held constant on conventional oil and gas to allow Ottawa room to increase its taxation of industry profits as oil and gas prices rise in future.
- Alberta offered, subject to federal government agreement, to lend funds for energy projects to other provinces. It offered to finance part of the cost of transporting Alberta gas to eastern Canada, to make interprovincial loans from the Heritage Savings Trust Fund, and to commit $2 billion to improving rail transport in western Canada.[8]

The federal response to the Alberta proposal was that Alberta established too firm a link to world oil prices, proposed oil price levels that were unacceptably high, and raised natural gas prices too quickly. The response also indicated that the proposal was viewed as not providing an adequate federal share of production revenues, as intruding into areas of expenditure that the federal government is responsible for, and as failing to recognize the federal constitutional right "to impose any manner or mode of taxation."[9]

[8] Government of Alberta, "Alberta's 'Energy Package' Proposal, Including Commitments for Canadian Energy Self-Sufficiency," mimeographed, Edmonton, July 25, 1980.

[9] See p. 8 of the Hon. Marc Lalonde's statement of August 1, 1980, released by the EMR in Ottawa

Negotiations on July 25, 1980, between the Prime Minister and the Premier of Alberta on this proposal and its federal counterpart failed to produce agreement on any aspect of the two proposals. Alberta's subsequent decision to raise the wellhead price of conventional crude a further $2.00 per barrel on August 1, 1980, was not disputed by Ottawa, however. When the NEP was unveiled in October, 1980, the impression was created that the federal government had decided to transfer to itself revenues from both the industry and the provincial governments and to assume responsibility for redistributing and reinvesting these revenues and for the control of production and consumption patterns and ownership of the industry.

But Alberta wanted more say in the pricing and taxation decisions. It did not think the negotiation process adequate.[10] To make clear its opposition, Alberta authorized oil production cutbacks beginning March 1, 1981, and halted consideration of oil sands projects, which by mid-decade will be crucial to Canada's supply prospects.[11]

The views and concerns that Alberta wants taken into account are not new concerns, and they are shared by the producing provinces in the West and by Newfoundland. The resource-producing provinces consider that, until recently, they have been low-income hinterlands. Recent increases in energy prices have increased their incomes. But the enlarged incomes are transitory because the resources are depleting, and alternative revenue and employment streams must be established to build the basis for maintaining current prosperity in the future. As part of their Confederation bargain, these provinces argue, they have paid higher-than-world prices for protected manufactured goods from Ontario and Quebec. Now it should be part of the same bargain that those residents pay the prices the producing provinces ask for their resources.

The producing provinces believe these prices should reflect commodity values in international markets. Indeed, it is argued, with higher wellhead prices and an appropriate fiscal regime, the development of oil and gas reserves in the West and offshore would fuel a major economic boom that would have spin-offs in other parts

[10] A rather complete account by the Alberta government of the lack of negotiation and of Alberta's offers can be found in a statement by the Hon. Mervin Leitch in the *Alberta Hansard*, November 3, 1980 (Edmonton, 1980), pp. 1337-43.

[11] The production cutback will be suspended if Canada experiences oil shortages (see "Transcript of Premier Lougheed's Address to the Province of Alberta in Reaction to the Federal Budget," Edmonton, October 30, 1980)

of the country, creating employment for, and raising the incomes of, Canadians in all provinces.

But economic studies have shown that rapid increases in domestic oil and gas prices would have other macro-economic impacts as well. Inflation would accelerate as the price increases pass through the system, unemployment would increase during the time it took employers to adjust to higher energy costs, and people would be poorer because they would be using more of their incomes to pay for their energy needs, leaving less for other items. Over a period of time, purchasing power would gradually shift from petroleum consumers to the governments of the energy-producing provinces and to the producers. If the latter reinvested the income, economic activity would shift to areas of investment activity, in the same way as has occurred on the international scene since 1973. If the income were not spent, the national economy could suffer severe deflationary consequences.

The producing provinces and the federal government are aware of the consequences of such income shifts for the management of the national economy. Alberta has offered loans to other provinces as a way of recycling some of the income in the economy and is developing investment plans within the province. However, it seems likely that substantial economic activity and population would have to shift to the West. Westerners view this prospect as their economic coming-of-age. For this reason the imposition of a different view by the federal government has provoked frustration, hostility, and anger against Ottawa and central Canada. Ottawa's alternative is to pursue a different method for distributing resource incomes and wealth among Canadians — by slowing the increase in petroleum prices and redirecting the benefits through the federal government to other regions of the country, thereby offsetting the income shift and reducing the incentives to shift economic activity and population. This is the view expressed in the NEP.

### Issues in the NEP Debate

There are a number of issues in the NEP debate, and several of them relate to the distributional strategy adopted by the federal government. Differences over distributional strategy, pricing, and taxation lie at the heart of the differences between the federal government and the governments of the producing provinces and at the heart of the policy impasse. The debate focuses on the consequences of the federal decision to redistribute benefits away from the industry and away from foreign-owned firms. Another major

concern of the debate is the goal of oil self-sufficiency, as well as the implications of the pricing decision for that goal. This section begins with an analysis of the NEP's distributional strategy and goes on to describe the debate with the provinces, the debate over changes in the fiscal regime of the petroleum industry, and Canadianization. Finally, it focuses on the oil self-sufficiency and pricing debates.

**Distributing the Benefits**

One of the major goals of the NEP is to distribute rents — the increases in incomes and wealth arising from the fact that the prices for petroleum have risen faster than the costs of finding, developing, and producing it from existing reserves. Rent is a term used by economists to measure incomes received from the exploitation of resource deposits that cost less to bring into production than is reflected by current market prices. In the absence of redistribution mechanisms, these rents accrue to producers at the expense of energy users. Holding the price of petroleum below its market value is one way to transfer rents to energy users — who then pay less than they would at the full market price. This is the method adopted in the NEP. Another option is to allow the price to rise and tax the rents away. The government that obtains these revenues can then transfer them to energy users through subsidies, tax cuts, or credits and through such transfers as equalization payments. This option is preferred by the producing provinces.

The concept of rent and its distribution lie at the heart of the economics — and much of the politics — of the NEP. However, the concept and its measurement are not well understood. In the public discussion of late 1980, this concept was sometimes confused with the division of production revenues — that is, with the increase in revenues resulting from an increase in the wellhead price for conventional crude oil. The NEP asserts that the federal share of production revenues would increase from roughly 10 percent pre-NEP to an average of 24 percent over the 1980-83 period, while the industry's share would be reduced by the NEP from 45 percent to 33 percent, and the western provinces' share from 45 percent to 43 percent (with Alberta's share being 35 percent).[12] Alberta hotly disputed this calculation, asserting that the federal government had underestimated its tax revenues and overestimated those of Alberta.[13]

[12] *NEP, op. cit.*, p. 108.
[13] Why the difference? There are several reasons:

Rents are different from production revenues and are more difficult to measure because they are net of the costs of production that vary from one oil or gas well to another and because future market prices are difficult to predict. Alberta has pointed out the value of rents it estimates it has given up by agreeing to lower-than-world oil prices.[14] The NEP refers to the benefits Canadian consumers derive from the blended price.[15] But how are these rents distributed among consumers, producers, and governments? How can the changes in their relative shares be evaluated? The NEP makes changes in the following ways:

- Energy users gain some of the rents because the wellhead prices for oil and gas are held below world prices. They benefit by the difference in the amount they would have to pay if they imported their oil and gas supplies. However, part of this share is reduced by the PCC collected by the federal government. Until at least 1983 all the PCC proceeds will be transferred abroad — to producers and governments in Venezuela, Saudi Arabia, and the other countries from which Canada imports its oil — although federal government expenditures from general revenues will be reduced.[16]

---

- Alberta taxes the energy industry lighter than do British Columbia and Saskatchewan, and the average provincial share calculated by Ottawa therefore overstates the Alberta take.
- The basis for division of revenues differs between Alberta and Ottawa. Alberta uses royalties and corporate income tax as the basis for its calculation of the division of revenues. Ottawa uses royalties, corporate income tax, and bonus bids accruing to the province from sales of drilling rights on land explored for oil and gas. Bonus bids raise the provincial share by 6 percent and lower the industry share. Alberta claims this income should not be included since it is neither production income nor a tax and since it varies from year to year depending on drilling activity.
- Ottawa does not include the PCC in its revenue calculations because it claims that this revenue is simply a transfer from oil companies refining domestic oil to oil companies refining imported oil. Ottawa includes the PCC in its revenues when this tax generates a surplus. Alberta says the PCC is part of the Ottawa oil pricing plan that allows Ottawa to keep the wellhead price low. This source of revenue should therefore be included in the revenue base.
- In late 1980 there were serious differences between Ottawa and Alberta over the calculation of likely revenue from the natural gas and liquids tax. Alberta believed world prices would rise more slowly than did Ottawa and therefore that there would be less revenue than Ottawa anticipated, requiring, for the imposition of the tax, that — in the absence of increases in world prices — the revenue be given up by Alberta. (See *Globe and Mail* [Toronto], December 8, 1980.)

[14] Alberta estimated the value of foregone revenues to total some $62 billion between 1980 and 1983 (see Alberta Department of Energy and Natural Resources, "Distribution of Revenues: Alberta Petroleum and Natural Gas Production," mimeographed, Edmonton, November 17, 1980).

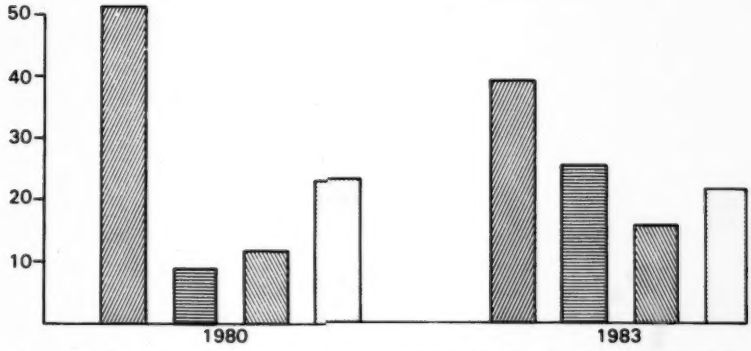
[15] *NEP, op. cit.*, p. 107.

[16] The PCC was calculated to produce an estimated $1.2 billion additional revenue in fiscal 1980/81 — some $2.7 billion less than the cost of oil imports. This sum

CHART 1

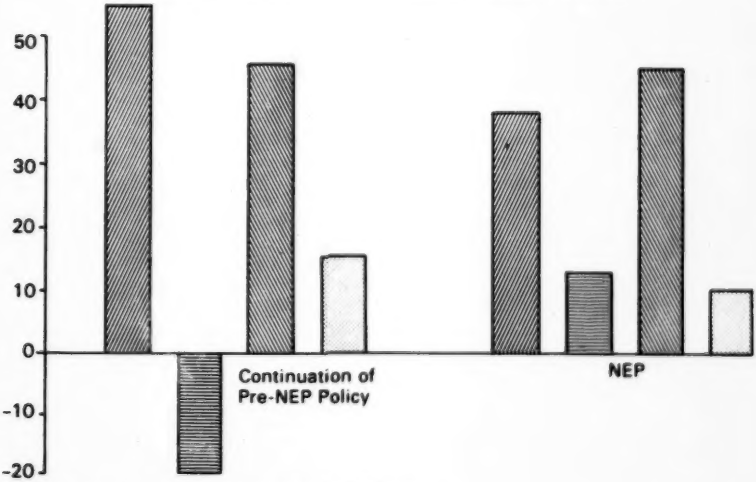
**Estimates of the Impact of the NEP on the Distribution of Resource Rents**
(percentages)

Gross Rents: Changes Between 1980 and 1983



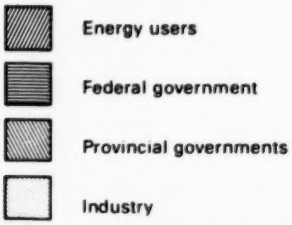

Source: Informetrica Limited, *Monthly Economic Review* 3, No. 12 (December, 1980).

Net Rent Flows,[a] with and Without the NEP, 1975-90




[a]Based on net present values, in 1980 dollars.

Source: The data for oil rents are from John F. Helliwell, "An Economic Evaluation of the National Energy Program," paper presented to the Annual Conference of the Canadian Tax Foundation, Montreal, November 26, 1980, Cases 2 and 5 (oil only).




• Rents to firms accrue in the form of excess or windfall profits over and above the costs of exploration, development, and resource production and allowing for a reasonable rate of return. These rents are reduced by the NEP through the imposition of the PGRT, which transfers 8 percent of gross revenues to the federal government; by the wellhead price, which is kept low; and by the natural gas and liquids tax, which also transfers revenues to the federal government.[17]

• The governments of the producing provinces also collect windfall incomes from royalties, land sales, and corporate income taxes. Under the NEP their share drops — being held down by low wellhead prices and the natural gas and liquids tax collected from their exports revenue.

• The federal government's share increases dramatically as a result of the NEP, mainly because of the added tax revenues.

Two independent assessments of the changes in rent distribution are illustrated in Chart 1. The difference in approach provides some insight into the difficulties of measuring the benefits from a change in policy such as the NEP. The first estimate compares the shares received by governments, industry, and the consumer in 1980 (pre-NEP) and in 1983 (post-NEP).[18] It is an estimate of gross rents — before governments pay incentives and subsidies to the industry but after energy users have paid the PCC. The share to the consumer is measured as the difference between the price of imported oil delivered to Montreal and the price of new Alberta oil de-

---

would rise to $3.5 billion in 1981/82 and to $5 billion in 1982/83, when revenues are expected to exceed the import bill. However, if increased imports are required in 1981/82 in response to the Alberta production cutback, these figures will most likely have to be revised. (See Department of Finance, *The Budget*, October 28, 1980 [Ottawa, 1980], p. 32.)

[17] Revenue from the natural gas and liquids tax alone will provide more than 43 percent of added revenues generated by the NEP. Revenue from the PGRT will provide a 48 percent share of added federal revenues in 1981/82, falling to 30 percent of the total by 1983/84. (*Ibid.*, p. 27.)

[18] Informetrica Limited, *Monthly Economic Review* 3, No. 12 (December, 1980).

livered to Toronto. The federal government's share includes federal corporate income tax, the PCC, and the PGRT but does not net out the oil import subsidy that is paid to foreigners. The provincial governments' share is based on royalty income, while the industry's share is based on an estimate of net operating costs. These costs are very difficult to calculate because of the variations between low- and high-cost wells.

The second estimate is a net rent calculation based on revenues net of payments for taxes, subsidies, incentives, depreciation, and capital costs.[19] This estimate is also based on flows — that is, on the present value of shares accruing over the 1980-90 period, based on historical shares between 1975 and 1980. Thus it compares shares that would have accrued if policy were unchanged with shares that will accrue because of the NEP.

The differences in share sizes in Chart 1 can be attributed to the differences in measuring gross and net rents and in measuring flows over a number of years rather than one year. What is obvious from the comparison, however, is that the largest share goes to Canadian energy users who do not have to pay world prices. This share declines as domestic prices rise during the decade.

The change in the federal revenue position is evident in both estimates, but the second analysis — of net rents — shows the dramatic change in the position of the federal government as a result of the NEP. Subsidy and incentive commitments placed it in a deficit position pre-NEP. This position changes to a surplus because of the added tax revenues that accrue to Ottawa under the NEP. The differences in estimating provincial and producer rents contribute to the difference in magnitudes, but what is important is the relative size and the direction — the provincial share tends to remain static, while the producers' share declines. Other NEP measures that affect the distributional picture are not shown in this chart. These include

- expenditures by the federal government to subsidize energy adjustment in eastern Canada and economic development in western Canada

[19] John F. Helliwell, "An Economic Evaluation of the National Energy Program," paper presented to the Annual Conference of the Canadian Tax Foundation, Montreal, November 26, 1980. In this estimate the energy consumers' share is also based on the difference between world and domestic prices for crude oil. The producers' share is based on net wellhead revenues after taxes; royalties; and operating, capital, and land costs have been deducted. The federal government's share includes all tax revenues accruing from the industry and from energy users net of oil import subsidies, incentive grants, and cost of capital, while the provincial governments' share adds in corporate income taxes and land payments as well as royalties.

- an increase in the share of production by Canadian firms relative to that of foreign firms because of replacement of the existing system of fiscal incentives for the industry by a system of grants through the PIP that gives clear preference in exploration and development to Canadian-owned firms
- the channeling of more production income to Canadian firms and the federal government because of measures such as the PIP and the reservation of the right of Petro-Canada to acquire an automatic 25 percent interest in frontier activity.

The change in the distribution of rent shares among Canadians is dramatic. It has created strong reactions within the industry and within the provincial governments, whose positions are negatively affected, and has introduced a number of risks. While most commentators agree with the principle of distributing the benefits of Canada's resources among all Canadians, several major issues have been raised concerning differences in the principles that should govern the means chosen by the federal government, the large and abrupt adjustments to the industry's fiscal regime, and the measures taken to Canadianize the industry. The risks for energy policy are that these responses will interfere with the development of oil supplies needed by mid-decade. These issues are analyzed below.

### *Differences in Principle*

No one disputes that resource ownership belongs to the provinces. This is clearly laid out in Section 109 of the BNA Act, which states that "all Lands, Mines, Minerals, and Royalties belong to the several Provinces of Canada," a right that was granted to the three Prairie provinces in 1930 in an amendment to the BNA Act.[20] What is disputed are the limits of the provincial resource ownership rights. Provincial governments argue that they have the right to make decisions about the timing and manner of development of their resources — and about pricing — under Section 92.5 of the BNA Act, which grants them legislative authority over "the Management and sale of the Public Lands belonging to the Province."[21]

The federal government believes that, through its own constitutional powers and in keeping with its responsibility for management, it has the power to restrict the exercise of these rights in the larger interest of the national economy. How Ottawa exercises these

[20] Department of Justice, *A Consolidation of the British North America Acts, 1867 to 1975* (Ottawa, 1976), p. 32.
[21] *Ibid.*, p. 27.

powers is the subject of considerable dispute.[22] These powers include Ottawa's control over interprovincial and international trade; the authority given to Parliament to make laws for the peace, order, and good government of Canada; and the declaratory power under Section 92.10(c) of the BNA Act by which "such works as, although wholly situate within the Province, are before or after their Execution declared by the Parliament of Canada to be for the general Advantage of Canada or for the Advantage of Two or more of the Provinces."[23] This latter power has been used by Ottawa to bring uranium mines under federal jurisdiction, and Alberta is concerned about its potential exercise in the question of oil sands development.

The dispute over rights of resource ownership crystallizes in matters of oil and gas taxation and pricing. The provinces have had bad experiences in their efforts to exercise these rights. Saskatchewan lost ground on disputes taken to the Supreme Court over its 1969 decision to set a floor price for potash and over a decision to create a new royalty and tax system for oil and gas. One of the core issues in taxation is interpretation of the apparent limitation on the provinces to direct taxation — which the courts say is a tax imposed on a producer with the intention that the producer shall bear the burden. Indirect taxes — such as income and sales or excise taxes — that a firm can pass on to consumers are considered, along with all other taxes, to be a federal prerogative. This dispute is complicated further by the provinces' interpretation of Section 125 of the BNA Act, which states that "no Lands or Property belonging to Canada or any province shall be liable to Taxation."[24] Under this provision, they argue, the federal government cannot impose an export or royalty-like tax, since this would be a tax on provincially owned resources.

The federal government can set the interprovincial and export prices of oil and gas under its regulatory authority over trade and commerce, as outlined in Section 91.2 of the Act. This authority is potentially enhanced by the Petroleum Administration Act, which was passed in 1975 and amended in November, 1980, to authorize the federal government to fix domestic oil and gas prices if negotiated agreements with the provinces could not be reached.

Still, at the root of the pricing issue is disagreement over rent sharing as oil and gas prices rise. Alberta recognizes the principle

---

[22] The Institute will be publishing a more complete discussion of these issues in a forthcoming issue of its Observations.
[23] Department of Justice, *op. cit.*, p. 25.
[24] *Ibid.*, p. 35.

of sharing the benefits of resource ownership among all Canadians and has accepted a lower-than-world oil price.[25] In return, it expects a commitment to respect its interpretation of the ownership rights of its depleting resource. Export taxes or royalty-like taxes at the wellhead are unacceptable because they preempt Alberta's prerogatives as a resource owner, and taxation of natural gas exports is considered discriminatory against the main producers, Alberta and British Columbia, especially when electricity, exported by Ontario and Quebec, has not been taxed since 1963. Nine provincial premiers went on record in August, 1980, as opposing such a tax and suggesting it violates the prohibition in the BNA Act on one government taxing the property of another.

Such taxes can reduce provincial revenues. If demand for Canadian gas is weak in the U.S. market, an export tax cannot be imposed on top of the price but must instead be deducted from it — thereby reducing provincial and industry revenues. To add on the tax could raise the price above market prices for substitute fuels in the United States and reduce demand volumes. The provinces argue that they will share the benefits of their resources with Canadians but that they are entitled to full value from resource exports abroad. Alberta also argues that it has adjusted its own royalty structure to make room for the federal government to obtain revenues from higher corporate income or profit taxes and that the federal government has the excise tax alternative to obtain revenues from consumers — alternatives that do not discriminate against oil and gas or against a particular provincial government.

The federal government's view is different. It believes wellhead prices for oil and gas should be held down as a means of distributing the benefits of these resources to all Canadians. But the federal government also needs revenues to carry out what it regards as its responsibilities for economic management — revenues to meet commitments to subsidize oil imports, to achieve equalization, and to pay exploration and development incentives. The federal government disputes Alberta's view of its depleting resources. The NEP, using Alberta's data, asserts that the established oil and gas reserves were larger in 1979 than in 1970 because the growth in the shares of natural gas and oil sands offset the decline in conventional crude oil.[26] To solve its revenue problems, Ottawa has resorted to taxing revenues that formerly went to producing firms and prov-

[25] See the transcript of Premier Lougheed's press conference in Ottawa on July 25, 1980, and "Excerpts from Premier Lougheed's Address to the Canadian Community Newspapers Association," mimeographed, Edmonton, August 16, 1980.
[26] *NEP, op. cit.*, p. 15.

inces. On the face of it the BNA Act gives the federal government the right to any mode of taxation, but because the natural gas tax includes the taxation of gas exports, Alberta went to court in early 1981.

The fact also remains that, under existing oil pricing and federal-provincial fiscal arrangements, the federal government's revenue requirements have risen. By fiscal 1980/81, the cost of subsidizing imported oil had reached $3 billion. The existing equalization formula required the federal government to increase payments to the "have-not" provinces as resource revenues grew in Alberta, Saskatchewan, and British Columbia. In 1979/80, revenues from natural resource entitlements necessitated payments by the federal government of $1.66 billion, and these were expected to increase to $1.85 billion in 1980/81.[27] More than one-third of the federal deficit — running at approximately $14 billion in 1980/81 — could be accounted for by fiscal requirements resulting from the combination of rising international oil prices and related domestic arrangements.

The differences in interpretation of the principle of provincial resource ownership are serious. The producing provinces believe they should play a role in managing the economic consequences of the rising value of their resources. Alberta's approach has been to offer to lend funds to other provinces to help them adjust their economic structures to the higher prices. It feels that the federal government disapproves of the idea of a particular province's accumulating revenues of the magnitude that makes Alberta's loan offers possible. The federal government believes it has a major role to play in managing the distributional consequences of the unequal ownership of resources among the provinces. But neither party seems to be listening or responding to the other.

*Adjusting the Industry's Fiscal Regime*

The second issue arising from the NEP approach to the distribution of revenues and rents is the impact on exploration and development activity of the abrupt changes in the fiscal regime of the oil and gas industry. The imposition of new taxation and the replacement of tax-based depletion and resource allowances by incentive grants encouraging activity into the frontier may have created unintended consequences that increase Canada's vulnerability to oil supply disruptions.

[27] Personal communication with the Department of Finance, December, 1980.

Prior to October 28, 1980, the structure of federal resource taxation provided a number of incentives to the oil and gas industry for exploration and, to a lesser extent, development.[28] These incentives meant that, if a firm reinvested its cash flow, it could appreciably reduce its income tax liabilities; so many firms qualified for exploration incentives in the late 1970s that the federal government's revenues were also reduced appreciably.[29] At the same time, world prices and the domestic wellhead price (before world prices doubled in 1979, Canada's price had increased to 76 percent of the former) rose much faster than production costs, thereby increasing returns to the industry, and it was logical to re-evaluate fiscal incentives. In the first six months of 1980, the Petroleum Monitoring Agency (PMA) estimated that overall industry operations yielded a rate of return on shareholders' equity of 22.4 percent — a 4.6 percent increase over the previous year — and higher-than-equivalent returns in the non-petroleum, non-financial industries.[30]

Questions to be asked in evaluating the NEP are whether the industry would have undertaken more activity with the existing fiscal regime than with the NEP and what level of activity is in the best interests of the nation. The NEP reduces the returns to producers and changes the incentive structure to favor Canadian ownership and control. This gives the impression that the policy's intention is not to encourage further conventional oil exploration but rather to reverse — using Canadian firms — seven years of diminishing activity in the frontier lands. Whether these changes will promote the best interests of Canadians is currently under debate, for several reasons:

- The Independent Petroleum Association of Canada asserts that many of the small Canadian firms the NEP has set out to help through the changed incentive structure are the most badly hurt,

---

[28] These incentives included a resource allowance in the form of reduced federal income tax to compensate for the non-deductibility of royalties paid to the provinces, a 100 percent write-off of exploration costs in the year they were incurred, a 30 percent write-off of development expenditures, a 10 percent write-off on land bonus payments, and an earned depletion allowance of 33⅓ percent of exploration costs and of certain capital equipment costs.

[29] Federal tax expenditures in the resource sector grew by 214 percent between 1976 and 1979, from $405 million to $1.3 billion (see Department of Finance, *Government of Canada Tax Expenditure Account* [Ottawa, 1980]).

[30] EMR, in its *1979 Canadian Petroleum Industry Monitoring Survey* (Ottawa, 1980), reported an increase in after-tax profits of 53.8 percent over 1978 and a net cash return on shareholders' equity of 33.5 percent. The industry hotly disputed this and other statistics in the report on methodological grounds. It was also argued that the higher-than-average rates of return were in recognition of the higher risks of exploration.

at least in the short run.[31] These firms regard the netback to the producer — the revenue received after payment of operating costs, royalties, and taxes — as their major source of funds for investment in further exploration activity. This netback has been reduced by the PGRT and, for natural gas producers, by the natural gas and liquids tax and the moratorium in 1981 on the increase in the gas wellhead price.[32] It is argued that the integrated companies have been less affected by the PGRT because a greater proportion of their revenues accrues from downstream (processing) activities.

- The Canadian Petroleum Association (CPA) argues that these taxes, together with the low wellhead prices, have reduced cash available to its members for reinvestment by as much as 35 percent over the 1981-85 period.[33] They also argue that the changes have reduced the rate of return on reinvestment and with it the incentive to seek external funding, which might have replaced cash flows as a source of funding.[34] It is acknowledged that the PIP will reduce the after-tax cost of investment for Canadian companies, but the CPA argues that decreased cash flows will discourage exploration because of the importance of netbacks in investment decision-making. In Chart 2 the effect of the PGRT on netbacks is shown.

- The PIP reduces the after-tax cost of investment for Canadian firms.[35] The intent is to restructure industry ownership and control by increasing access to exploration funds for small Canadian firms that pay no taxes and therefore did not have access to the pre-NEP allowances and tax write-offs.[36] There have been indications that these firms distrust the administration of grants because of the possibilities for favoritism and arbitrary administra-

---

[31] Earl Joudrie (Independent Petroleum Association of Canada, Calgary), "Notes for Remarks to the Men's Canadian Club of Ottawa," January 13, 1981.

[32] The PGRT falls on the total revenue stream for exploration firms who receive all their income from sales of oil and gas and, because it is not deductible from their income tax, has the impact of reducing corporate profits by as much as 25 percent. The large firms, mostly foreign-owned, have refining, marketing, and other income sources that are not subject to the PGRT.

[33] Canadian Petroleum Association, *Submission to the National Energy Board Hearing on Energy Supply/Demand*, Vol. 3 (Calgary, 1981), p. 14.

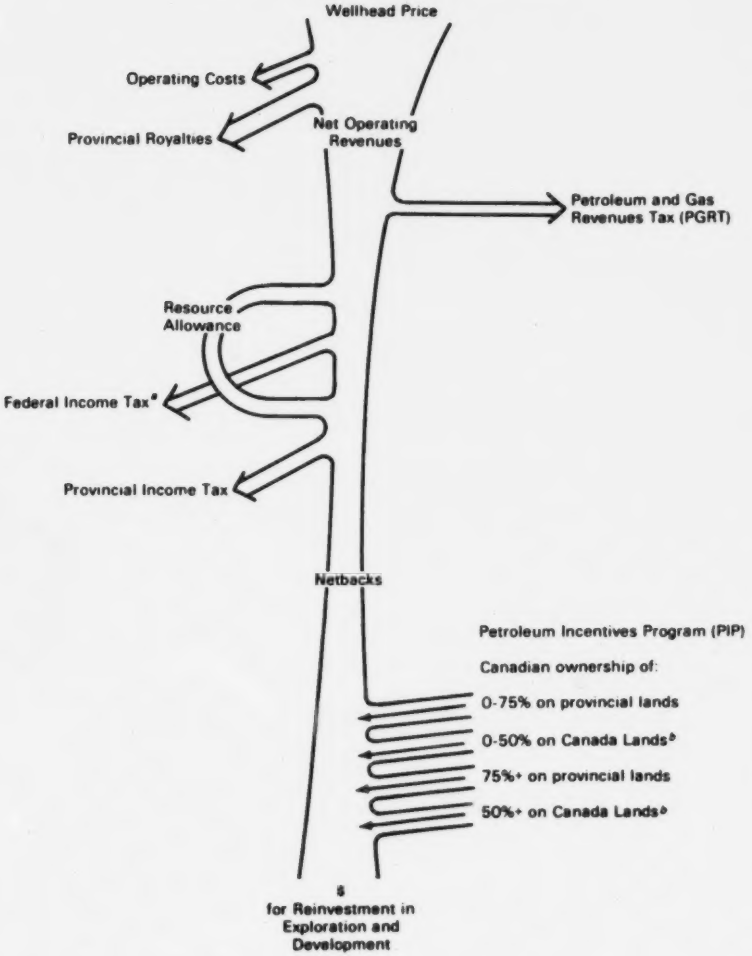
[34] *Ibid.*

[35] *NEP, op. cit.*, p. 39.

[36] The changes in the NEP include the reduction or elimination of earned depletion allowances. In 1981 the depletion allowance will continue to be earned at 33⅓ percent, net of the PIP. The allowance will be phased out by 1984 outside of Canada Lands. The allowance has been eliminated for conventional oil and gas development but retained, net of the PIP, for oil sands, enhanced recovery, and heavy-oil upgrading. The ceiling for earned depletion deductions will be 25 percent of resource income.

CHART 2

**The Fiscal Regime of the Petroleum Industry**




[a] Depending on eligibility for write-offs, allowances, and so on.

[b] Depletion allowances on qualifying expenditures will be net of incentive payments.

Sources: Canadian Petroleum Association, *Submission to the National Energy Board Hearing on Energy Supply/Demand*, Vol. 3 (Calgary, 1980); Department of Energy, Mines and Resources, *The National Energy Program, 1980* (Ottawa, 1980), p. 40.

tion. It has also been charged that the new system risks perverse consequences. Since the largest grants are available for exploration in frontier areas, the system discriminates against activity on provincial lands, against conventional oil, and, in the short run, against natural gas, which is the activity in which most small Canadian firms are engaged. Most of these firms argue that they lack the necessary capacity to move on to frontier areas to take advantage of the richest incentives. However, these arguments have to be weighed against evidence from the Geological Survey of Canada, which suggests that, over the next decade, exploration in frontier areas will be more fruitful than in western Canada, and against the fact that excess supplies of natural gas exist.[37] They also have to be weighed against the alternative that exists for the producing provinces to reduce their royalties and restore the attractiveness of activity on provincial lands. This alternative has been acknowledged by the industry. The industry also regards the privilege reserved by the NEP for Petro-Canada to acquire a costless 25 percent interest in new discoveries as a powerful disincentive to activity.[38] The federal government has defended itself on the grounds that it is paying 25 percent of all exploration costs and that the carried interest is fair exchange. One interesting possibility that has received very little attention to date is that this carried interest might be auctioned off to Canadian firms to provide access for them to frontier activity.[39]

- Deregulation of oil prices in the United States is another factor. Canadian firms that depend on netbacks compare those available in the United States with those in Canada. They point to netbacks five times higher for new oil and 2.5 times higher for natural gas.[40] They reason that, because they lack the capacity to take risks in the North, they should move to the United States.

Another aspect of the change in the fiscal regime is its negative impact on foreign-owned firms. Taxation and low wellhead prices reduce their windfall profits; they also face higher costs for exploration and development because of the structure of the PIP. After-tax,

[37] The results of a survey by the Geological Survey of Canada released in March, 1981, include the estimate that 22,000 exploratory wells would have to be drilled in western Canada to find between 2.6 and 3.3 billion barrels of oil, compared to seventy-five exploratory wells in the Mackenzie Delta-Beaufort Sea area, and 150 wells on the east coast, to find similar volumes of oil. The report points out that many frontier sources will be difficult and costly to locate, but the effort in western Canada will also be costly. (See R. M. Procter *et al.*, "Canada's Conventional Oil and Gas Resources" [Calgary: Geological Survey of Canada, March, 1981].)

[38] *NEP, op. cit.*, p. 47.

[39] *Energy Update* 2, No. 21 (November, 1980).

[40] Canadian Petroleum Association, *op. cit.*

after-incentive exploration costs rose 43 percent on provincial lands for a foreign firm over what they were pre-NEP. On Canada Lands these costs dropped from 37 to 28 cents per dollar spent on exploration by foreign firms, but they dropped from 37 to 7 cents for Canadian-owned firms.[41] The NEP argues that retaining the earned depletion allowances for a period will cushion the foreign firms while they change their ownership structure to qualify for the PIP and implies that Petro-Canada will be able to cushion the momentum of exploration activity in Canada.

A number of questions have been raised about the risks created by this abrupt change in incentives. To date, foreign firms have played a major role in the exploration of the frontier. They have had the resources to undertake the risks involved in such costly long-range activity. The adjustment of fiscal incentives to eliminate returns for such risks has at least temporarily reduced both the certainty and the confidence necessary to undertake further activity. Canada may have few alternatives unless other Canadian firms respond to the new incentives, as Dome Petroleum Limited did in February, 1981, and unless foreign firms, now faced with a fiscal position they see differing little from that of a riskless public utility, cut back their Canadian activity.[42] The NEP's intention to rely increasingly on the public sector is probably a viable option despite the industry's widespread skepticism. However, lead time will be necessary in order to increase capacity to undertake extensive high-risk, large-scale operations.

By early 1981 there were signs that, while the goal of restructuring the industry was unchanged, administration and regulations might be altered in several ways. Ownership requirements were eased, and firms were permitted to improve their revenue position by calculating the PIP and deducting it from the PGRT. There were also signs that the controversial right of Petro-Canada to acquire retroactively 25 percent of frontier discoveries would be dropped, that exploration expenses would be redefined, and that the application of the natural gas and liquids tax would be changed in certain uses.

---

[41] See *NEP*, *op. cit.*, p. 96.

[42] Dome Petroleum Limited will gain access to maximum exploration incentives by forming Dome Canada Limited, a company that will probably be 75 percent Canadian-owned. Dome Canada will be created with a $400 million share issue, of which 55 percent will be offered to Canadians only. Dome Petroleum will account for an additional 13 percent of the ownership, and Dome Mines Limited will make up the balance because it is considered wholly Canadian-owned. (See *Energy Update* 3, No. 3 [February, 1981].)

*Canadianization*

The goal of increasing Canadian participation in, and ownership of, the oil and gas industry, as spelled out in the NEP, has been discussed but has never been as seriously acted upon. To illustrate how widely accepted the notion of Canadianization has become, one should consider that, in its 1980 proposal, Alberta committed itself to achieving 50 percent Canadian ownership of the oil sands. However, the NEP expresses the concern that 50 percent ownership of production be achieved more quickly and more extensively than the present trend.

The thrust of the scheme is to ensure that more of the income and wealth accruing to firms in the industry accrue to Canadians. The means employed by the NEP — preference to Canadian-owned firms for exploration and development, expansion of the role of Petro-Canada, and declaration of intent to buy out foreign assets — reflect an apparent belief that the goal is achievable within an acceptable period of time only by intervention and control, not by taxation or incentives.

The argument developed in the NEP is that federal pricing and taxation policies contributed substantially to the development of the industry — but by foreigners. As oil prices and industry profits have risen, a share of Canada's resource wealth has been transferred into the hands of foreigners. It seemed unlikely that, under existing federal policy, ownership and control would be transferred to Canadians because these policies provided cash flow to the industry sufficient for it to expand operations without seeking debt or Canadian equity participation. Today, seventeen of the largest twenty-five firms are more than 50 percent foreign-owned and account for 72 percent of oil and gas sales. This ratio is gradually declining — the Department of Energy, Mines and Resources reported that, in 1979, Canadians owned nearly 40 percent of assets.[43] It is argued, however, that most of these assets are in exploration and development — the upstream portion of the industry — while foreign firms control most of the revenue and much of *future* production through the control of land to be explored. It is further argued that, because foreign-owned firms reinvest part of their earnings in the non-petroleum industry, their influence on the Canadian economy will grow if left undisturbed. The NEP relies on acquisitions of foreign firms and on the enlargement of the public sector role as the "only equitable way to meet quickly [the] goal of increased Canadian ownership."[44]

[43] EMR, *Petroleum Monitoring Survey*, *op. cit.*, p. 26.
[44] *NEP*, *op. cit.*, p. 51.

Canada's desire to reduce foreign control of its increasingly valuable resource industries is not unique. Indeed, Canada is one of the few non-OPEC nations other than the United States that has not moved to exert control through a strong public sector presence and heavy taxation of windfall profits. Both the United Kingdom and Norway are frequently cited as examples, and this aspect of the NEP resembles policy in Norway.[45] However, there are important differences in the policy environments. In the European countries the public sector presence was developed to exploit the exciting new finds in the North Sea, and foreign companies knew the rules of the game when they entered it (although taxes have been raised frequently in the United Kingdom). Because both countries allow world prices for oil, even with heavy public sector presence and taxation, participation is attractive to the private sector. In Canada the situation is quite different. The North and offshore areas to be explored are costly and have often proved disappointing, the price for oil in these areas has not yet been established, the PIP discriminates against foreign firms, and the rules of the game have been changed. In short, the economic environment in these areas has been altered to make it attractive to Canadian-owned firms, many of whom seem to doubt their capacity to take up the opportunity.

The reasons for the apparent haste to Canadianize are not clearly understood. According to EMR's 1979 survey, Canadians owned nearly 40 percent of the assets in the petroleum industry and controlled 36 percent of them.[46] This degree of Canadian participation was up from 10 percent and 22 percent, respectively, in 1971 because of the activities of such companies as Petro-Canada, Alberta Energy Company Ltd., Alberta Gas Trunk Line Company Limited — now known as Nova, An Alberta Corporation — and Dome Petroleum. The NEP's assertions that large annual dividend, interest, and capital outflows were attributable to foreign firms are not entirely true. As shown in Table 2, more than 50 percent of net capital outflows in the 1975-79 period were the result of Canadian takeovers and Canadian investments abroad. Canadian outflows increased 86 percent over the period (column 5), while foreign direct investment declined (column 4). However, gross dividend outflows increased 45 percent during this period, accounting for 83 percent of gross outflows in the industry (column 2). This trend could be altered — but probably only marginally — by changing the owner-

[45] Norway Ministry of Petroleum and Energy, "Storting Report No. 53 (1979-80) Concerning Activity on the Norwegian Continental Shelf" (Bergen, 1980). This is an unofficial translation.

[46] EMR, *Petroleum Monitoring Survey, op. cit.*

TABLE 2

**Gross Interest and Dividend Outflows and Net Direct Investment, Petroleum and Natural Gas Industry, 1975-79**
(million dollars)

| Year | Interest (1) | Dividends (2) | (1) + (2) (3) | Foreign Direct Investment in Canada[a, b] (4) | Canadian Direct Investment Abroad[a, c] (5) |
|---|---|---|---|---|---|
| 1975 | 69 | 387 | 456 | +5 | -130 |
| 1976 | 72 | 288 | 360 | -424 | -120 |
| 1977 | 90 | 423 | 513 | +379 | -98 |
| 1978 | 108 | 562 | 670 | -771 | -439 |
| 1979 | n.a. | n.a. | n.a. | -110 | -242 |

n.a. = not available

[a] A plus sign (+) indicates net inflows, while a minus sign (-) indicates net outflows.
[b] Negative flows in 1978 are largely accounted for by Petro-Canada's takeover of Phillips Petroleum Company's holdings in Pacific Petroleums Ltd. and Kaiser Resources Ltd.'s takeover of Ashland Oil Canada Limited.
[c] Net outflows are accounted for by investments abroad by junior and senior Canadian companies.

Sources: Statistics Canada, *Canada's International Investment Position*, 1977 (Ottawa, 1981), and unpublished data from its Balance of Payments division.

ship and control of the industry to achieve the NEP's 50-percent-of-production goal.

The haste seems to relate to control. Foreign-owned firms are subsidiaries that will continue to operate in Canada because they have few other places to go. The PMA estimated that capital expenditures by the industry in the first half of 1980 totaled $3.5 billion, up 38.7 percent from the first half of 1979. Of this total, 60 percent was accounted for by the integrated companies and the foreign-controlled seniors.[47] While most of these expenditures were for upstream activities (exploration and development), 66 percent of the downstream (processing) expenditures were accounted for by the integrated companies and the foreign-controlled seniors.[48] This type of reinvestment reflects a desire to diversify activities in light of declining reserves, but it widens these companies' control of the economy. One way to halt such a trend is to reduce the earnings available to undertake such expansion.

A key economic question in this debate is whether Canadians will be better off with less foreign ownership and control of the petroleum industry. The NEP has not presented a convincing case that foreign ownership and control of the petroleum industry have reached crisis proportions, although official concerns have for some time been based on evidence contained in, for example, the Gray Report. Indeed, in the least clearly articulated part of the policy, Canadians are asked to pay for acquisitions of foreign firms by more foreign borrowing and by what amounts to a regressive, inflationary tax. The irony is that no new oil reserves will be created. But the share in Canadian economic activity held by foreigners will be reduced — now and in future. Whether a Canadian-owned public sector presence will be more efficient than have been foreigners is not clear. An active, capacious public sector will probably be a more compliant arm of public policy than would an unwilling private sector. But the large foreign firms currently have the capacity to explore and develop, and it is questionable whether Petro-Canada or Canadian firms other than Dome Canada Limited will be able to move into the vacuum within the next four years.[49] The possibility that a few large Canadian firms will take over the foreign-owned companies is not to be ruled out, however — but such a possibility could

---

[47] Petroleum Monitoring Agency, *Monitoring Survey: 1980 First Six Months, Canadian Petroleum Industry* (Ottawa, 1980), p. 21.

[48] *Ibid.*

[49] The NEP points out that Petro-Canada currently accounts for 60 percent of Canadian-held exploration permits on Canada Lands, while Dome Petroleum holds a further 15 percent (*NEP, op. cit.*, p. 21).

also mean that foreign control will be exchanged for increased concentration by Canadian firms.

Another aspect of the Canadianization issue has emerged. The additional taxation proposed to pay for takeovers of such firms as Petrofina Canada Inc. will raise oil prices to Canadian consumers higher than the Liberal government's election commitment — and higher than it is willing to raise them at Alberta's request. The funds required will have to leave the country to pay for the takeover, with negative repercussions for the exchange rate, because, if the funds remain in the country, they will be used by the foreign recipient to acquire other assets — which is part of the problem the policy is trying to solve.

The question has been raised of whether there are alternative ways to achieve the ownership and control targets. Could the same goals be achieved by means of increased regulation and surveillance of the industry and increased Canadian presence — both public and private — in new activity? It has been suggested that a requirement that all firms prove 50 percent Canadian ownership by a specified date could be imposed. Windfall profits taxes might also be legislated to reduce the earnings available for expansion, but this move would likely require closer surveillance of the industry. Closer surveillance is already a fact, however, because of the COR — which will be based on annual verification of the proportion of Canadian share ownership.[50]

Another aspect of the debate over Canadianization that may develop in 1981 relates to the perspective on the NEP taken by the U.S. government. General concerns about this nationalistic thrust of the NEP have been reported, and specific repercussions may occur over domestic procurement policies in the frontier areas. The NEP intends to ensure that applicants for exploration and production rights on the Canada Lands demonstrate the Canadian benefits of their proposed operations.[51] This intention could be exercised in a way that breaches Article III of the General Agreement on Tariffs and Trade (GATT), and this possibility has proved an irritant to the U.S. government. Requiring private firms to give domestic content preference would constitute such a breach because it would treat imported goods less favorably than domestic goods. An alternative that would not likely constitute such a breach is the institution of purchasing policies that affect all firms and provide the opportunity

[50] See Dunnery Best, "Energy Rules May Be Altered," *Financial Post*, January 17, 1981, p. 1. By early 1981 it was becoming evident that strict adherence to the rules would be costly and that their interpretation would have to be eased.

[51] *NEP, op. cit.*, p. 47.

to Canadian suppliers to be considered along with potential foreign suppliers. If the U.S. government judges that the Canada Oil and Gas Act (which contains the legislation to implement this aspect of the NEP) breaches this article of the GATT, it may lodge a formal complaint or, if bilateral discussions fail to clear up the matter, invoke retaliatory powers under the U.S. Tariff Act. A further complication is created by the NEP's intent to treat U.S.-controlled firms already established in Canada differently than Canadian firms. The Canadian government argues that it has reserved its position on the OECD convention governing such behavior, but this defense may not be accepted by the United States and could also provoke retaliatory action.

**Security of Supply**

Achieving security of oil supply is one of the NEP's primary policy goals. A major critique of the policy is that it will move Canadians further away from such a goal by endangering the new supplies that must be developed during the decade and because of the unrealistic goals it has set for reducing Canadian oil consumption by 1990. In this section we will evaluate the meaning of the goal and the NEP strategy to achieve it and raise the question of whether the NEP was really serious about achieving this goal.

The concept of, and strategy for, achieving oil self-sufficiency have been under discussion since the early 1970s. At that time the federal government decided to embark on a program for meeting all domestic oil requirements from domestic sources, realizing that, in an uncertain international environment, dependence on foreign sources of supply becomes increasingly undesirable because of the consequences of even temporary supply disruptions.[52]

Achieving oil self-sufficiency requires adjustments in both demand and supply. One option is to increase domestic oil supply, another is to substitute other energy sources for oil, while a third is to increase conservation. To achieve these adjustments, either drastic increases in prices or direct intervention in the form of incentives and regulation are needed. The most feasible combination of measures is complicated by the fact that prices and the fiscal treatment of the oil industry chosen for distributional reasons may conflict with this objective.

Self-sufficiency was first chosen as a goal in 1973, when, although Canada exported more oil than it imported, the reliance on imports in eastern Canada meant that easterners were extremely

[52] See the Prime Minister's speech in *House of Commons Debates*, *op. cit.*

vulnerable to external disruptions. Canadians lost this self-sufficient status in 1975, when declining domestic producibility, growing domestic requirements, and policy decisions reduced exports at the same time that imports increased. In 1976 the policy goal was expressed as "self-reliance" — meaning that domestic requirements should be met as much as possible from Canadian supplies, but not at any cost. The goal could be achieved by reducing vulnerability to external disruptions while allowing for limited reliance on imports and use of emergency preparedness against disruptions. In 1979, self-sufficiency was again adopted as an explicit goal, with higher oil prices and the gasoline excise tax as central policy instruments. Even so, by 1980, Canadians were importing roughly 25 percent of total oil consumption.[53]

The NEP differs from past policy in its substitution of security of supply as a goal for the concepts of self-sufficiency and self-reliance. It represents a strategy that places more emphasis on reducing oil demand by substituting other energy sources and by conservation. It places less emphasis on price increases and excise taxes and more emphasis on fiscal incentives and regulation. However, in pursuing these strategies, the NEP runs the following risks:

- That oil supplies will not be forthcoming during the decade at the pace anticipated in the NEP because of low returns to producers, because of reduced cash flow and rates of return that the industry argues are needed to explore for new supplies and undertake the oil sands projects, and because of the impasse with Alberta.
- That the targets for reduced oil demand will not be reached because energy users will not be persuaded by the standards and incentives that the NEP relies upon to induce substitution away from oil and conservation. Small price increases in the first three years and prospects for slow economic growth add to the risks.

By early 1981 a number of estimates of the NEP's impact on supply-demand balance had been made, and none agreed with the NEP's assertion that net oil imports would be eliminated by 1990.[54] Instead, it was estimated that, over the decade, Canada would become increasingly dependent on imported oil. Whereas the NEP admits net imports will grow by 21 percent between 1979 and 1985 — even with its optimistic projections of reduced consumption —

[53] *NEP, op. cit.*, p. 7.

[54] *Ibid.*, p. 98. By EMR calculations, net imports, which totaled 215,000 barrels per day in 1979, will rise to 260,000 barrels per day in 1985 and then be eliminated by 1990. The reduction in import dependence will result from oil sands production and from a large reduction in oil for non-transportation use by households and businesses.

five other estimates suggest that net imports will grow to roughly 300,000 barrels per day in 1985 and to more than 500,000 barrels per day in 1990.[55] One must remember, however, that each estimate is based on different assumptions about the responsiveness of households and businesses to changes in oil prices and to changes in the oil and gas pricing structure. Most estimates are also severely limited by their inability to take account of the impacts of key NEP incentives and regulations to reduce oil demand, since these effects are very difficult to model. Furthermore, each estimate is based on differing assumptions about the future role of oil sands in Canada's supply picture. Nevertheless, there is a message that the NEP may be incurring serious risks for Canadians' future security of oil supply while giving an impression to the contrary.

*Overestimated Supply Response*

The NEP recognizes that total domestic oil production will decline by 19 percent between 1979 and 1985 but estimates that it will rise by 6 percent between 1985 and 1990 because of the increasing share of the oil sands. The share of oil sands and enhanced recovery in total production is expected to rise from 6 percent in 1979 to 24 percent in 1985 and to 48 percent in 1990. Frontier supplies from the Beaufort Sea and Hibernia are not included in these estimates (see Table 3).

Clearly, non-conventional oil plays a crucial role in Canada's domestic supply picture. Yet the NEP and the reaction to it have led to obstacles to the development of non-conventional and frontier supplies.

- Alberta considers its control of production to be the key bargaining tool in its dispute with Ottawa. The decision to delay approval of the Cold Lake and Alsands projects until a negotiated settlement is reached with Ottawa has created the possibility that these projects will be completed much later and at a higher real cost than assumed in the NEP. Although these projects are like great factories at the oil sands sites, numerous technical obstacles have to be overcome during assembly, large skilled work forces have to be recruited, and special equipment has to be imported or built in Canada. Because of the magnitude of energy projects under way all

[55] Helliwell, *op. cit.*; T. E. Daniel and H. M. Goldberg, *The Impact of Oil and Gas Pricing on Canada's Energy Supply and Demand Situation*, Working Paper 80-3 (Edmonton: University of Alberta, 1980), p. 11; Canadian Petroleum Association, *op. cit.*; Shell Canada Limited, "Supplement to Submission to the National Energy Board" (Toronto, January, 1981); Imperial Oil Limited, "Modified Submission to the National Energy Board," Vol. 1 (Toronto, December, 1980).

TABLE 3

**Uncertainties in Oil Supply-Demand Balances, 1979-90**
(thousand barrels per day)

| | 1979 | 1985 | 1990 |
|---|---|---|---|
| *NEP Demand* | | | |
| Transportation | 870 | 875 | 865 |
| Residential, commercial, and industrial | 553 | 340 | 210 |
| Other | 400 | 400 | 400 |
| | 1,823 | 1,615 | 1,475 |
| *Pre-NEP Demand* | | | |
| Reduction in demand attributable to NEP | 0 | 290 | 334 |
| | 1,823 | 1,905 | 1,809 |
| *NEP Supply* | | | |
| Conventional oil | 1,388 | 914 | 713 |
| Non-conventional oil | 102 | 326 | 733 |
| Pentanes plus[a] | 118 | 114 | 73 |
| Total domestic production | 1,608 | 1,355 | 1,520 |
| Imports | 215 | 260 | 0 |
| | 1,823 | 1,615 | 1,520 |

| | 1985 | 1990 Without Frontier | 1990 with Frontier |
|---|---|---|---|
| *Post-NEP Supply Possibilities*[b] | | | |
| Conventional oil | less than 914[c] | 713 | 713 |
| Non-conventional oil | 102 | 326 | 326 |
| Frontier oil | ? | 0 | 200 |
| Pentanes plus[a] | 114 | 73 | 73 |
| Total domestic production | 1,130 | 1,112 | 1,312 |
| Imports required to satisfy NEP demand | 485 | 363 | 163 |

[a] Pentanes plus is a fuel by-product obtained from the production and processing of natural gas.

[b] This is a simplified scenario that takes into account the following possibilities:
- that conventional oil producibility declines faster than NEP estimates (see note *c*)
- that delay of the oil sands projects in 1981 delays production by at least two years, so that 1985 levels are not much better than 1979 levels and production by 1990 is only what the NEP expects for 1985
- that frontier sources come on stream by 1990 at the level predicted in 1981 for Hibernia. The Beaufort Sea is omitted from this calculation. In early 1981, Dome Petroleum Limited estimated that production in the next decade could average between 200,000 and 300,000 barrels per day.

[c] Because the PGRT increases the rate at which existing wells are shut in.

Source: EMR, *op. cit.*, pp. 94 and 99.

over the world, considerable competition exists for this manpower and equipment, and cost escalation is therefore a major source of uncertainty. These problems may become more serious over the 1981-85 period if the synthetic fuel projects in the United States proceed rapidly. Delay in the Canadian projects will mean that real costs will continue to escalate, and with the alternative opportunities available to the teams that have been assembled, each week of delay increases the chances that they will leave. Industry sources have pointed out that a project that takes five years to assemble can fall apart in a week and that it will not be reassembled easily or cheaply, since skilled labor and equipment must be bid away from other opportunities.

- Even if approval were forthcoming from Alberta, it is dubious that the projects would proceed because the industry considers the oil sands reference price, escalated annually by the CPI, to be inadequate to allow for the unanticipated cost increases and because the PGRT reduces the anticipated rate of return. These factors may be amenable to negotiation, however.

- Because of the way it structures incentives for provincial lands, the NEP reduces the attractiveness of conventional oil exploration. The PGRT also accelerates the rate at which existing wells are abandoned as uneconomic. Furthermore, since the NEP doubles the wellhead price of conventional oil by 1986, there are additional incentives to leave it in the ground right now.

- The reduced netbacks in Canada relative to those in the United States may mean that Canadian activity will move south at a faster pace than has already occurred.

- The restructuring of incentives to Canadian firms favoring activity on the Canada Lands may not make this activity sufficiently attractive because no price has been established for frontier oil and because Arctic exploration to date has been costly and disappointing.

Some of the risks the NEP takes on the supply side are factored into the section in Table 3 on post-NEP supply possibilities, together with a missing ingredient — frontier production from the Beaufort Sea and from the Hibernia discovery off the coast of Newfoundland. The potential of the Hibernia play is receiving increasingly favorable reports.[56] If these reports prove valid and production is possible at an attractive price, the entire supply scenario on which the NEP is based could change. While import requirements could double by

[56] Jeff Carruthers, "Hibernia Flow Seen at 200,000 Barrels a Day," *Globe and Mail* (Toronto), December 9, 1980.

1985, they would be significantly reduced by Hibernia supplies by 1990. Official estimates of the potential should be forthcoming from the National Energy Board (NEB) when it reports on the hearings on Canada's supply-demand position in all energy sources. The addition of Hibernia to official oil reserves estimates will be only part of the story, however. Production from Hibernia will also depend on the outcome of a jurisdictional dispute between Ottawa and Newfoundland over offshore mineral rights. The NEP includes the eastern offshore areas in the Canada Lands, which both Nova Scotia and Newfoundland dispute.[57] Ottawa believes it should administer the offshore and share some of the revenues with the adjacent provinces until those provinces have achieved an agreed level of wealth. The provinces dispute this approach, claiming that they should administer the offshore in the same way as they do provincial lands onshore.[58]

*Demand Reduction Overestimated*

The NEP estimates that total oil demand will drop more than 2 percent annually between 1979 and 1990. This dramatic move by Canadians away from oil is to be achieved by a large drop in oil consumption for non-transportation uses — nearly 15 percent a year over the decade, mainly through the substitution of natural gas for oil and, to a lesser extent, through conservation. In contrast, the share of transportation demand remains virtually unchanged. The main off-oil response is to be effected in eastern Canada by means of subsidized prices for natural gas that reduce its price to 67 percent that of oil on a heat-equivalent basis by 1983 and establish the Toronto city gate price in Montreal, Quebec, and Halifax.[59] In addition, conversion and conservation costs for homeowners are to be subsidized, making both actions commercially attractive investments.

The off-oil strategy represents a viable policy option. Indeed, the NEB approved a major natural gas supply project in Quebec in April, 1980. One of the main features of the project was that TransCanada PipeLines Limited and Q & M Pipe Lines Ltd. (now known as TQM) would lower the price of gas to 65 percent of the heat-

[57] *NEP, op. cit.*, p. 42ff.

[58] This dispute escalated in January, 1981, when Newfoundland issued a permit to the Newfoundland and Labrador Petroleum Corporation. This may bring the federal and provincial governments into opposition because Petro-Canada has conflicting claims to mineral rights on the Grand Banks. (See *Oilweek*, January 12, 1981, p. 66.)

[59] *NEP, op. cit.*, p. 32.

equivalent price for oil in order to induce consumers to switch.[60] Estimates of oil imports to be displaced by the project ranged from 50,000 to 55,000 barrels per day by 1985 — an estimate that represents 17 percent of the NEP's reduction estimate. However, the NEP estimate is based on assumptions that as many as 2.15 million households now heating with oil will convert; 59 percent of the target is located in Quebec and the Maritimes and 33 percent in Ontario, where half the residences already use natural gas.[61] Of the half that do not, more than 65 percent are thought to be located in areas served either by gas mains or by existing distribution franchises. Prospects for industrial conversion will be affected by restructuring incentives to replace cheap residual fuel oil with natural gas.

The biggest risk appears to be in the conservation program. The crucial question is how quickly energy users will respond to the increase in the blended price — an increase of 70 percent between December, 1980, and December, 1983. The sensitivity of demand to price increases has not been precisely estimated in Canada, but estimates in the United States and other OECD countries suggest that a 10 percent price increase results in anywhere from a 2 percent to an 8 percent reduction in energy demand.[62] The time it takes to achieve this response is quite uncertain, however, and the impact in three years of a 70 percent rise in prices is difficult to predict. Instead, the NEP conservation response is based on incentives and regulation; the latter will require leadership and careful coordination among departments and levels of government to carry out, and these may not be forthcoming in the way the Department of Energy, Mines and Resources anticipates.

The feasibility of the conservation goals can be compared to estimates made by the Canadian Energy Research Institute (CERI) in 1980. CERI estimated that, if existing homes were insulated, more efficient modes of transportation were substituted, and extensive conservation measures were undertaken in the commercial sector, as many as 176,000 barrels of oil per day could be saved by 1985 and that this figure would increase to 214,000 barrels per day by 1990.[63] To achieve these savings, however, the legislation of

---

[60] National Energy Board, *Reasons for Decision in the Matter of the Applications under Part III of the National Energy Board Act of TransCanada PipeLines Limited and Q & M Pipe Lines Limited* (Ottawa, 1980).

[61] EMR, "Oil Substitution Program," mimeographed (Ottawa, 1980).

[62] See, for example, William Nordhaus, "Oil and Economic Performance in Industrial Countries," *Brookings Papers on Economic Activity* 2 (1980): 341.

[63] W. B. Friedenberg and A. J. Nixon, *Prospects for Reduced Oil Consumption in Canada*, Working Paper 80-4 (Calgary: Canadian Energy Research Institute, 1980).

standards, regulations, and subsidies and incentives would be necessary.[64]

The conservation response — particularly in the industrial sector — will also depend on the rate of economic growth, projected in the NEP to average 3.2 percent over the decade. Since 1972, through a variety of measures, Canadian industry has increased energy efficiency by 13 percent. Eventually, however, continued efficiency gains will depend on the replacement of existing capital stock with more efficient machinery and equipment. Since investment decisions depend on expected demand, they are more likely to be undertaken in a fast- rather than a slow-growth environment.

In summary, in early 1981 the risks created for the supply response to the NEP appeared to be serious primarily because of Alberta's decisions. The risks on the demand side seemed somewhat smaller. Although the conservation responses anticipated by the NEP seemed overly optimistic in the absence of larger increases in the CPI, the off-oil response seemed possible to achieve.

On balance, the NEP appears to increase the vulnerability of Canadians to supply disruptions, particularly in the mid-1980s, when vulnerability will increase anyway. But the question of whether Canadians face greater risks of shortages and gasoline rationing by then as a direct result of the NEP must be raised. This possibility, which is clearly seen by Canadians in the oil and gas industry and elsewhere, is a source of major frustration because energy policy is viewed as an instrument that, if it had not made choices that endanger supply, could have fueled a boom that would make Canada a net oil exporter. While this point, expressed by western Canadians and the oil industry, may be self-serving, it is not necessarily incorrect. A major factor in this dispute is the way the NEP uses oil prices to achieve its goals.

### Pricing

The third major concern in the NEP is the level and pace of increases in Canadian oil prices to producers and to energy users. There are widely differing views in Canada about how quickly and how far the producer price should rise and how these increases should be passed on to the consumer. Alberta believes the producer price should be determined in relation to world oil markets. If Ottawa pays market prices for Mexican and Saudi Arabian oil, it is argued,

[64] The authors estimate that an additional saving of 183,000 barrels per day would be possible by 1985 if the domestic price increased by $5.00 per barrel annually until then, followed by an $8.00 per barrel increase until 1990.

why shouldn't Alberta producers receive as much as 75 percent of that price? Since most of Alberta's oil will be depleted by the end of the century, revenues from market prices are needed to diversify Alberta's economy to provide continuing prosperity to future generations of Albertans.

Ottawa believes differently. The world price can be rejected as a reference for the domestic price because the world price is determined by a cartel intent on adjusting supply to manipulate the price. It is believed that Canadians can replace current oil imports and declining production from conventional oil sources at costs below the world price — by switching to natural gas, by means of increased conservation, and by replacing supplies with frontier oil and oil sands sources. The NEP depends on regulations and incentives to promote efficient uses of oil and gas. By keeping the price low, the energy user benefits from not having to pay world prices. However, there is some dispute over whether the producer price is high enough. The price has to signal to both producers and energy users the higher costs to people who must replace scarce oil with alternative domestic sources. Yet, as shown in Table 4, this price will be held at less than half the estimated world price until 1984.

Producers dispute the pricing schedules and reference prices in the NEP as inadequate to cover costs inclusive of a reasonable return and an incentive to explore for new supplies. The lack of apparent incentives in the producer pricing schedule suggests that the NEP is based on an assumption that most oil located in southern Canada has already been found — an assumption that seems to have some basis in the geological evidence cited above. The signal to consumers is mixed — prices are clearly subsidized below the cost of replacement supplies (oil sands and frontier sources) until mid-decade. The signal of increasing scarcity is to be found in the price *schedule*, not in the current price. But some observers have noted that the credibility of the schedule is weakened by the possibility that it could be changed with the next budget or another election.

The choices in the NEP raise a number of important issues:

• *Tying to the world price*. While the federal government rejected the Alberta oil pricing proposals in the summer of 1980 as being too close to the so-called arbitrary international price (Alberta proposed to move wellhead prices to 75 percent of the Chicago price by January, 1984 — a reduction from 85 percent), the NEP

TABLE 4

**Domestic Oil Prices and Their Relation to International Prices, Canada and the United States, 1974-90**

| | Canada | | | |
|---|---|---|---|---|
| | Domestic Price[a] | World Price[b] | DP/WP | United States[c] |
| 1974 | 5.77 | 11.06 | .52 | .59 |
| 1975 | 7.26 | 12.54 | .58 | .62 |
| 1976 | 8.50 | 12.86 | .66 | .63 |
| 1977 | 10.22 | 14.84 | .69 | .63 |
| 1978 | 12.19 | 16.14 | .76 | .65 |
| 1979 | 13.19 | 22.85 | .58 | .66 |
| 1980[d] | 15.52 | 37.08 | .42 | .70[e] |
| 1981[f] | 18.75 | 40.79 | .46 | |
| 1982 | 20.75 | 44.87 | .46 | |
| 1983 | 22.75 | 49.35 | .46 | |
| 1984 | 27.25 | 54.29 | .50 | |
| 1985 | 31.75 | 59.72 | .53 | |
| 1986 | 38.75 | 65.69 | .59 | |
| 1987 | 45.75 | 72.26 | .63 | |
| 1988 | 52.75 | 79.48 | .66 | |
| 1989 | 59.75 | 87.43 | .68 | |
| 1990 | 66.75 | 96.18 | .69 | |

[a] Wellhead prices for conventional oil, in Canadian dollars.
[b] Saudi Arabian benchmark crude, in Canadian dollars, delivered to Montreal.
[c] Based on a ratio of the average domestic wellhead price, in U.S. dollars, to the landed price of Saudi Arabian benchmark crude, also in U.S. dollars.
[d] January to September, inclusive.
[e] Projections are based on an 8 percent inflation rate and a 2 percent real annual increase in the world oil price. As a result, the ratio remains unchanged in the projection. As the price of oil is deregulated, this ratio will rise toward 1.
[f] Projections are based on an inflation rate of 8 percent and on an annual real price increase of 2 percent.

Sources: U.S. Department of Energy, *Monthly Energy Review*, December, 1980 (Washington, D.C.: U.S. Government Printing Office, 1981); Canadian data were provided by the Department of Energy, Mines and Resources, Energy Policy Coordination branch.

commits Canadians to a blended price that will never exceed 85 percent of that same arbitrary price.[65]

- *Arguments favoring a lower price to maintain a competitive edge for Canadian producers*. These arguments, accepted by Alberta,

[65] *NEP, op. cit.*, p. 30.

Ontario, and Ottawa, are flawed, for two reasons. First, Canadians with lower-than-world prices produce more energy-intensive goods than their competitors — aluminum, newsprint, and petrochemicals are prime examples. These goods, when sold at world prices abroad, bring artificial advantages to their producers and may induce unwarranted growth in their industries. Second, as producers take advantage of the lower prices, the Canadian industrial structure remains more energy-intensive than that of the rest of the world, thereby attracting more of these producers, forestalling changes to the less energy-intensive structures of competitors, and building an outmoded (by world standards) industrial structure.

- *Lack of credibility of price schedule*. The NEP price schedule for producers and consumers may rapidly become outmoded. The producer price schedule assumes more or less orderly international oil markets throughout the 1980s. Yet it is likely that international prices will again increase appreciably during the decade, meaning that the reference prices may also have to change. Furthermore, the decision to increase oil and gas prices gradually has been influenced by the same internal political factors that have created problems for energy policy in the past. In 1976 the federal government indicated its intention to increase oil prices more rapidly toward world prices than it has done in the NEP. Those planned increases were subsequently postponed. Will the fate of the NEP be any different? It is likely that factors — such as anticipated recession and external shocks — that played a role then will also affect the NEP in future. The slow pace of price increases in the NEP schedule, while having the advantage of assisting energy users in preparing for the transition, at the same time set the stage for more or less constant federal-provincial disputes and for the paralysis that instantly befell the NEP.

- *Risks of producer pricing*. The NEP's intention is to establish a conventional crude oil price schedule that increases prices as low-cost supplies run out and to establish reference prices for non-conventional oil that are high enough to cover costs and a reasonable return. Wellhead prices for natural gas producers are not increased in 1981 to allow for phasing in the natural gas tax. This increased regulation of pricing reflects an approach designed to assure that windfall gains are transferred from producers to the federal government. But several risks in this approach have been noted. If prices are set too low to allow for risk taking, vital exploration and development activity will not be undertaken. The policy aims to eliminate windfall gains but does not take into account the possibility of windfall losses. This possibility is particularly relevant

for explorers (who, if Canadian-owned, benefit from the PIP) as well as for oil sands producers, who must operate in an environment containing costly technical obstacles. This approach also presents the anomaly of paying world prices for imported oil, thereby transferring income from Canadians to foreign producers because of a policy that seeks to avoid transferring income to Canadian producers.

**Summary**

The extensive debate over the NEP in late 1980 and early 1981 has brought out many differing perceptions of how these policy goals should be achieved. There is little serious dispute that maintaining a lower-than-world oil price is one way to distribute among Canadians in all regions some of the income and wealth accruing from increasingly valuable energy resources. But one of the factors that contributes to the policy impasse discussed below is that it is not the only way. Nor is there much dispute over the proposition that the benefits be retained in Canada. There is virtual unanimity as to the desirability of reducing Canada's vulnerability to disruptions in imported oil supplies, although there seem to be varying assessments of the degree of urgency.

The NEP debate has focused mainly on strategy. The main elements in the debate, discussed in the preceding sections, can be summarized as follows. The petroleum industry has objected to the policy changes in the fiscal regime, warning that reduced cash flow and replacement of tax-based incentives with exploration and development grants will restrain future industry activity. The industry has objected to the restructuring of incentives to encourage activity in frontier areas because many Canadian firms lack the capacity to operate there. By early 1981 the federal government had demonstrated a willingness to modify some of the regulations in response to industry criticism. The petroleum industry has noted that Alberta and the other producing provinces have the option of changing their royalty structures to restore the attractiveness of activity on their lands. Furthermore, recent evidence from the Geological Survey of Canada suggests that geological prospects are relatively more promising for future exploratory activity on the frontier than in western Canada. The possibilities for Canadian firms to benefit from exploration grants became somewhat more apparent as a result of Dome Canada's decision.

There are also opposing views of the strategy chosen to Canadianize the industry. Some groups feel the policy does not go far enough. But many in the private sector expressed concern about

growing public sector presence through the acquisition of foreign firms. Others objected to the use of resources for acquiring foreign firms instead of creating new petroleum reserves. They felt that the same targets for ownership and control could have been achieved by regulation, taxation, and greater surveillance of the industry.

Considerable concern has been expressed about the strategy to achieve oil self-sufficiency because of the NEP decision to emphasize reduction of oil demand — a departure from the past practice of relying on expansion of oil supply. The petroleum industry stressed the risks created by the policy for future oil supply, particularly because of Alberta's decision to delay the oil sands projects. But widespread skepticism has been voiced about the feasibility of the targets set to induce people to switch off oil and to conserve in the absence of large price increases.

The pricing and taxation measures in the NEP were the subject of the most widespread and sustained controversy because of the fundamental differences between Ottawa and the producing provinces and the resulting policy impasse. These measures will be discussed below, together with the possibilities for resolving the impasse.

**The Impasse in 1981**

Differences over pricing and taxation measures in the NEP lie at the heart of the post-NEP impasse between Ottawa and Alberta because of the impact of these measures on the distribution of the benefits of petroleum resources. Alberta argues that it has already shared a significant portion of the benefits with other Canadians and is willing to continue doing so by proposing a wellhead price schedule that increases to only 75 percent of the North American price. The NEP pricing proposal is considered arbitrary, and the PGRT and the natural gas and liquids tax discriminatory. Alberta is using its control over production to oppose these measures and to force renewed negotiations. However, the federal government has decided to use its powers over pricing to maintain a wedge between producer and consumer prices large enough to create the tax revenues it needs to carry out what it considers are its responsibilities for managing the consequences for the national economy of unevenly distributed resource wealth.

Each side in the impasse has failed to take seriously the major concerns of the other. Alberta has not accepted the federal government's requirement for increased and more certain revenues. The federal government has not recognized how federal policies such

as the NEP appear to create, instead of remove, stumbling blocks to the realization of economic potential in the West.

All Canadians are worse off with the impasse than they would be under the NEP — or even with Alberta's July, 1980, proposal — because the oil sands projects are stalled and import requirements have increased. The NEP gives Canadians the impression that they will be paying lower prices for oil than proposed by Alberta and that they will be better off. Yet one of the main consequences of the impasse is that Canadians stand to be worse off as a result of reduced economic activity and increased vulnerability. The producing provinces believe that there is a better way to spread the benefits of resource ownership among Canadians — by allowing producer prices to rise and thereby generate activity in the West. Some estimates accepted by the Ontario government suggest that, of the $200 billion that might be spent on oil- and gas-related projects over the next ten years, $67 billion — or 32 percent of the total value — would accrue to Canadian manufacturers.[66] One calculation of the economic impact of the Alsands project puts the total undiscounted monetary effect over the life of the project on the Canadian economy at $44 billion (1978 dollars).[67] Some of the questions that have been raised are: What is the advantage to Ontario of low prices for domestic oil if, in exchange, it loses the jobs and added income from the oil sands? What are the advantages to Canadians of lower domestic oil prices if they pay higher prices to foreigners for the increased imports — and face the possibility of disruptions in those supplies?

In early 1981 much of the public debate focused on finding ways out of the political impasse, mainly by Ottawa's raising the wellhead price toward that contained in Alberta's July, 1980, proposal. While there was no expressed flexibility in Ottawa's position, the potential existed, in two respects:

- Ottawa has declared its intention to further tax energy users to establish the Canadian Ownership Account in order to provide some of the revenues needed to acquire foreign assets. If non-budgetary ways of achieving the Canadianization goals were established, the fiscal room created could be used to raise the wellhead price some distance toward Alberta's price schedule. Indeed,

---

[66] Larry Grossman, *Interprovincial Economic Co-operation: Towards the Development of a Canadian Common Market* (Toronto: Ontario Ministry of Industry and Tourism, 1980).

[67] Alsands Project Group, "Social Impact: Benefit/Cost Analysis," presented to the Alberta Energy Resources Conservation Board in support of an Oil Sands Mining Project (Calgary, 1979).

there are indications that takeovers by the private sector will contribute to the goals, although it appears that Petro-Canada's February, 1981, takeover of Petrofina will be financed by an additional levy on oil users.

- After the March 1, 1981, production cutback, Ottawa imposed an additional levy on energy users to finance the additional oil imports. Further cutbacks will require additional levies. Why pay this levy to foreigners? Why not raise the wellhead price toward that proposed by Alberta in return for a revocation of the production cutback?

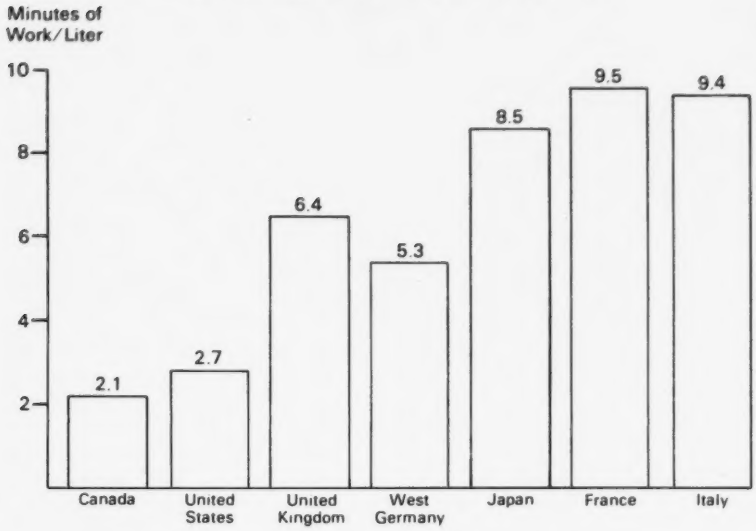
As Chart 3 illustrates, the energy user in Canada is well-off compared to users in other OECD countries. The average Canadian must work roughly two minutes at the average manufacturing wage to pay for a liter of gasoline, while wage earners in other OECD countries (except the United States) must put in three times as much time to buy the same quantity. Even so, raising the wellhead price will affect some users more than others — particularly those dependent on oil for space heating and on private automobiles for transportation — and they should be cushioned by a refundable energy tax credit. It should be noted, however, that, in the absence of a negotiated price increase, everyone must pay the higher levies to cover imports, with no apparent prospect of the cushion that could be provided by the tax credit.

A compromise on wellhead pricing would be beneficial to Canadian energy users, since they would be better off than with the current impasse or with the 1980 Alberta proposal. The petroleum industry's difficulties would be eased by the higher price, and Canadians in central Canada would benefit from restoration of the economic momentum from the oil sands plants. The producing provinces would welcome the added wealth accruing to them because they regard it as a temporary — and in their view overdue — consequence of the rules of the federal system. The federal government would continue to satisfy its revenue needs and would even reduce the expenditures required for oil imports. In addition, a greater conservation response could be expected.

These are some of the reasons why a compromise by means of raising the wellhead price has received so much attention. The higher wellhead price seems to be a necessary element of any settlement. Indeed, Alberta has indicated this to be the case. Some observers have suggested that the NEP will be accepted intact without price increases because the creation of Dome Canada showed a way to satisfy Canadianization requirements and because Petro-

CHART 3

**International Comparison of Terms of Trade, Working Time per Liter of Gasoline, December, 1980**




Sources: United Nations, Statistical Office, *Monthly Bulletin of Statistics* 34, No. 6 (June, 1980); Great Britain, Central Statistical Office, *Annual Abstract of Statistics*, 1980 (London: Her Majesty's Stationery Office, 1980); Statistics Canada, *Employment, Earnings and Hours* 57, No. 12 (December, 1979); Organisation for Economic Co-operation and Development, Department of Economics and Statistics, *OECD Economic Outlook* 28 (December, 1980); Canada, Department of Energy, Mines and Resources; Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Foreign Exchange Rates*, January 7, 1981.

Canada's acquisition of Petrofina created progress toward the desired public sector presence. Together with the easing of regulations found onerous by the industry, the result could be increased pressure by the industry on Alberta to soften its opposition. But as has also been pointed out, the impasse resembles a bargaining situation in which both sides have set out their extreme positions. Both positions will have to be modified, for several reasons. If Ottawa does not compromise, the affront to the West that the NEP represents will remain to trouble future federal-provincial relations. Indeed, it is not clear that a higher wellhead price by itself will break the impasse because the taxation measures could still remain un-

acceptable to the producing provinces. But raising the wellhead price does appear to be a key element in the short-term solution. Over the longer term, federal policies must be more sensitive to western economic aspirations.

Alberta and the producing provinces must compromise too. They must address the issue of federal revenue requirements. The legality of the natural gas and liquids tax is currently before the courts, but it would provide 45 percent of the additional revenues accruing to Ottawa under the NEP. The producing provinces can act to restore activity in the West, but they must address the central issue of redistributing within Canada the income from their petroleum endowments. Ottawa will have to be more flexible in addressing the role to be played in recycling petroleum revenues within the national economy. Alberta has already made a number of loans for capital projects in other provinces.[68] Repayment of these loans will contribute to the future income stream Alberta seeks to establish, and at the same time the Heritage Savings Trust Fund provides a domestic alternative to borrowing in foreign capital markets. Certainly the costs and benefits to the federal system from increased interprovincial financial activity should be assessed and should become part of the public debate on economic management.

**Conclusion**

The NEP is an economic policy that is severely constrained by political factors. It represents the federal view of how Canada's energy resources can be used as a tool to orchestrate the country's economic future, with the federal government conducting and playing the leading role.

But Canada has a federal system in which powers of resource ownership must be exercised cooperatively. Ottawa has failed to realize that, in order to achieve acceptance of the NEP, it has to create a broader climate of confidence in the West by showing that it recognizes and accepts that region's economic aspirations. The NEP produced a coherent strategy but failed to produce a process for its successful realization without creating greater divisiveness in the existing system.

All Canadians will be worse off if the political impasse drags on. In early 1981 the debate focused on the apparently simple solution that Ottawa compromise by raising wellhead prices for oil over

[68] See Alberta Treasury Department, *Alberta Heritage Trust Fund Annual Report, 1979-80* (Edmonton, 1980). In 1979/80, nearly $1 billion in loans was outstanding to six other provinces.

the next three years. But this view overlooked the taxation measures contained in the NEP, which the West perceives as an important barrier to its economic aspirations. Resolution of the impasse will be a complex matter in which each side must recognize the needs of the other — something each has thus far failed to do.

Another longer-range aspect of the NEP must also be addressed. The NEP implicitly takes the view that Canada can afford to trade self-sufficiency for restructured distribution. This policy represents a timely departure from the past in its emphasis on reducing oil demand. It is unlikely that there will be any going back on these fundamentals. But the policy takes risks. If the attractiveness of competing activity in the United States has been underestimated, if reduction in oil demand has been overestimated, if the oil sands projects are delayed much longer, and if the response to frontier options is weak, Canadians may pay lower prices and own more of their industry by mid-decade, but they should also be aware that part of the price may be lineups at the gas pumps.

## Policy Analysis Committee

The C. D. Howe Institute Policy Analysis Committee (HIPAC) was formed in 1980 from the Canadian Economic Policy Committee, established in 1961. This change was brought about to help streamline the Institute's activities and to improve the process of accountability of staff to the Institute's members.

HIPAC's membership is drawn primarily from business and labor organizations that are members of the Institute. To encourage diversity of perspective, HIPAC also includes members from the academic world, from agricultural organizations, and from the professions. A network of Regional Advisory Committees is being established across the country to assist HIPAC in determining its research agenda and in ensuring that the research conducted by the Institute on its behalf is relevant and reflective of regional points of view.

Full meetings of HIPAC's membership are held twice each year. The purposes of these meetings are to hear expert speakers on current policies, to engage in frank discussion of topics raised by members, and to identify a research program that the Institute can effectively carry out to improve public understanding of important policy issues. The professional completion of this program is then supervised by the Institute's Policy Research and Analysis Division, which coordinates with the HIPAC Executive Committee.

Publications prepared under HIPAC supervision include:

- *Policy Review and Outlook* — an annual survey of Canada's economic performance and policy issues and options.
- Observations — concise monographs, prepared by Institute staff, analyzing specific topics of current policy interest.
- Policy Commentaries — monographs of varying lengths prepared by technical experts analyzing current or prospective policy issues.

The Co-Chairmen of HIPAC are David M. Culver (President, Alcan Aluminium Limited) and Donald R. Montgomery (Secretary-Treasurer, Canadian Labour Congress). H. A. Hampson (President and Chief Executive Officer, Canada Development Corporation) is Chairman of HIPAC's Executive Committee. Wendy Dobson directs the Institute's Policy Research and Analysis Division and coordinates with HIPAC.

**Observation Series**

19 *Housing Needs and Economic Policy: The Mortgage-Interest- and Property-Tax-Deduction Proposal*, by Richard Shaffner (April, 1979)

20 *Exports to Developing Countries: An Opportunity for Canada*, by Wendy Dobson (July, 1979)*

21 *The Exchange Rate As a Policy Instrument*, by Wendy Dobson (May, 1980)

22 *Responsible Regulation: Rules versus Incentives?*, by Léon Courville (August, 1980)

23 *Canada's Energy Policy Debate*, by Wendy Dobson (May, 1981)

*Out of print.

## C. D. Howe Institute

The C. D. Howe Institute was established in 1973 by the merger of the C. D. Howe Memorial Foundation and the Private Planning Association of Canada. It is a non-profit, non-political organization seeking to contribute non-partisan research findings and commentary on Canadian economic policy issues.

The guiding principle of the Institute is to conduct its research and analysis in a manner that is balanced in approach, professional in method, and readable in style.

To ensure diversity in perspective, participation is encouraged from organized labor, business, agricultural associations, and the professions.

While its focus is national, the Institute recognizes that Canada is composed of regions, each of which may have a particular point of view on policy issues, unique interests and concerns, and different concepts of national priorities. The Institute also pursues involvement from both of Canada's major linguistic communities.

It is not the purpose of the Institute to promote consensus on policy issues, although on occasion that may be feasible. The primary function is to add to public understanding of issues by providing sound analysis reflecting objective treatment of diverse points of view.

Although governments and their departments are excluded from Institute membership, the staff of the Institute seeks to develop good working relationships with public officials for the purposes of better understanding the basis for government decisions and contributing effectively to public policy formulation.

A Board of Directors is responsible for the general administration of the Institute, while the immediate direction of the policies, program, and staff is vested in the President. The function of the Board is to make independent research and publication possible under the most favorable conditions and not to control the conduct and conclusions of research activity.

Shirley Carr and W. J. Bennett are Co-Chairmen, and Carl E. Beigie is President and Chief Executive Officer, of the Institute. Other officers are Michel Amiot, Vice President, Administration, and Treasurer; Barbara Hodgins, Vice President, Western Division; and Romana Cap, Corporate Secretary.

The Institute's publications are available from its offices: Suite 2064, 1155 Metcalfe Street, Montreal, Quebec H3B 2X7, and Suite 410, Mount Royal Village, 1550 - 8th Street S.W., Calgary, Alberta T2R 1K1.